CREDI December 2015

"Winter is coming"

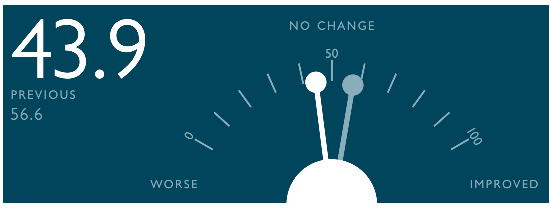
In the December survey, the CREDI Main index noted a significant fall of 12.7 points to the current figure of 43.9. The reduction was driven by a sharp decline in the Current situation index from 63.1 to the present level of 42.3. This suggests that the survey lenders and borrowers have encountered increasingly difficult financing conditions over the past three months. The Expectation index also declined to 45.5, meaning that both of the two underlying indices are below the turning point of 50.0 for the first time since 2012.

This December issue of the CREDI report indicates an increasingly cautious approach by property companies, banks and investors. The financing market is going through a cooling-down period, which is reflected in the number of preference share and bond issues during the second half of 2015. The market capitalization of the listed companies still exceeds the book value of equity (EPRA NAV) by more than 20 per cent.

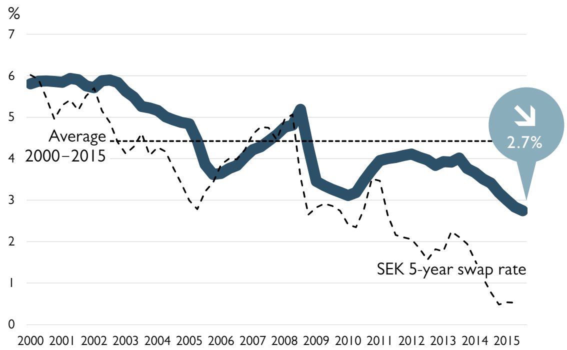
The CREDI Main index noted the largest drop since the start of the survey in May 2012, decreasing 12.7 index points. The Main index in the December survey is thus 43.9, which is well below the 50.0 turning point. The fall was primarily driven by a sharp decline of 20.9 index points in the Current situation index to 42.3 in this December survey. The Expectations index also declined, but significantly less, falling from the turning point of 50.0 to 45.5. Consequently, all of the Main index components are below 50.0, which has not occurred since the September 2012 survey. The results from the 2015 December survey clearly suggest that the polled banks and property owners believe that the market is in the credit contraction zone. The sub-indices relating to access to financing, credit margin and leverage all indicate that financing conditions have become more difficult and will become increasingly so over the next three months.

The CREDI indices represent third-quarter company figures. Therefore, they provide a good comparison between the market sentiment three months ago and the current market sentiment reflected in the CREDI survey. The downward trend in average interest rates persisted in Q3 2015, decreasing to 2.7 per cent, which once again represented a historical low for the listed sector. The current loan-to-value of 54.3 per cent represents a 1.1 per cent decrease from the preceding quarter and may indicate that the banks are more conservative in their lending.

CREDI Main index

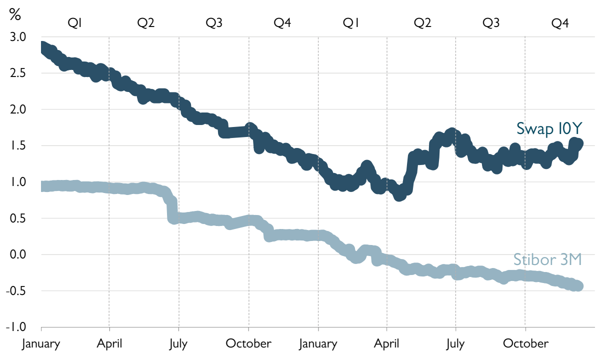


CREDI Indices – Q3 Average interest rate*



* Average interest rate on outstanding debt portfolio as reported by each company.

Swedish key interest rates, 2014 and 2015



About CREDI: The Catella Real Estate Debt Indicator, CREDI, is a market sentiment indicator for the Swedish real estate debt financing market. CREDI consists of two parts; a quarterly current and forward-looking survey of Swedish listed property companies and banks providing real estate financing on the Nordic market; and a set of indices based on publicly available data illustrating the aggregate change in credit conditions such as leverage, duration and cost of debt for the Swedish listed property sector. Subscribe to CREDI at catella.se/CREDI

The CREDI Survey

In this December survey, the Main index experienced a significant fall, declining by 12.7 points to 43.9, a level well below the turning point of 50.0. A more prudent outlook was observed in nearly all sub-indices and, for the first time since the September survey in 2012, both the Current situation and the Expectation index are below 50.0. This indicates that both the polled lenders and borrowers believe that the financing conditions have become more difficult and will become increasingly so.

Main index components

In the December survey, there was a significant decline in the Main index to 43.9 (56.6), driven by a fall in both the Current situation index and the Expectation index. The Current situation index was the main contributor and experienced a historical decline of 20.9 index points to 42.3. This is the first time since 2012 that the Current situation index is below the turning point of 50.0. Furthermore, a contraction was also observed in the Expectation index, which fell from 50.0 to 45.5. Consequently, also the forward-looking index fell below the 50 turning point for the first time since 2012.

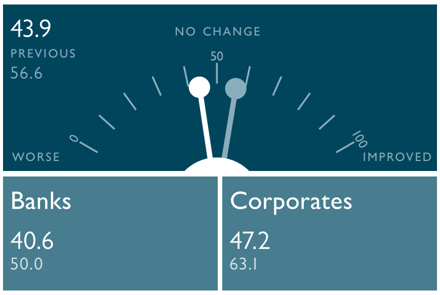
The previous September CREDI survey was predominantly characterised by two features. Firstly, there was a substantial difference between the Current situation and Expectation index. Secondly, the Current situation index was higher than the Expectation index, indicating that the polled lenders and borrowers generally have a more cautious view of the next three months. However, in this December survey, the gap declined by more than 100 per cent and this is thus the first time since 2012 that the Expectation index is higher than the Current situation index.

Sub-indices

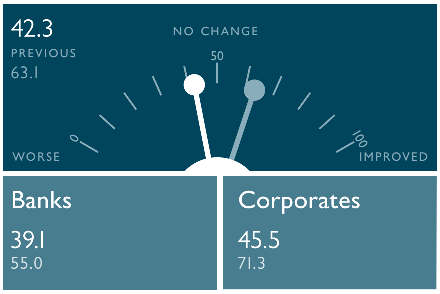
In this December survey, all of the underlying Current situation sub-indices declined. The Current Credit Availability and Current Credit Margins sub-indices fell significantly – by 33.3 and 34.5 index points, respectively – to a level well below 50.0. Only the Current Duration sub-index remained above the turning point at 54.5. This indicates that both the banks and property owners experienced more difficult financing conditions over the past three months.

An overall decline was also experienced by the Expectation sub-indices for the December survey. The Leverage and Credit Margins sub-indices fell by 3.1 and 9.4 index points, respectively, to below 50.0, suggesting that polled lenders and borrowers believe in a credit contraction in these two segments in the next three months. Access to financing is also believed to become weaker, whereas duration is expected to increase slightly.

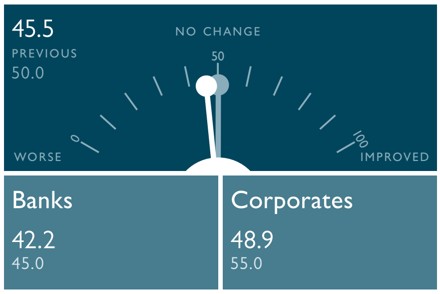
CREDI Main index



Current situation



Expectation

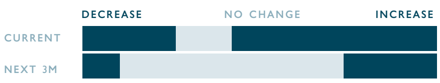


CREDI Sub-indices

CREDI Sub-indices present survey data question by question. The bars represent the distribution of actual answers per question, separated into the components Current situation and Expectation for the coming three months.

CREDIT AVAILABILITY

CREDIT MARGINS



LEVERAGE

DURATION

ABOUT THE CREDI SURVEY

CREDI is a market sentiment indicator for the Swedish real estate debt financing market. The indicator is based in part on a quarterly current and forward-looking survey of Swedish listed property companies, and banks providing real estate financing on the Nordic market.

The CREDI survey contains four questions about recent changes in credit availability and credit conditions, and four questions about expectations regarding changes in credit availability and credit conditions in the next three months.

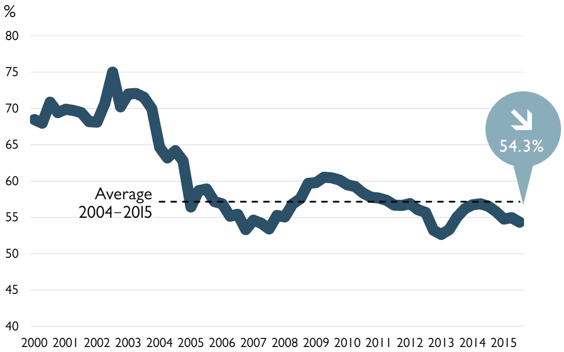
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. The final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 50. Consequently, the turning point in sentiment is 50 and any reading below indicates more difficult financing conditions while any reading above indicates less difficult financing conditions.

Separate indices are aggregated per respondent category. The Main index and its components are then computed as an unweighted average of these two categories – ensuring that the answers of borrowers and lenders are equally weighted in the Main index.

The CREDI Indices

In reported data from Q3 2015, the majority of the trends observed in the listed sector over the past quarter persisted. The average loan-to-value and the average interest rate declined to 54.3 per cent and 2.7 per cent, respectively, meaning that both remained below the historical mean.

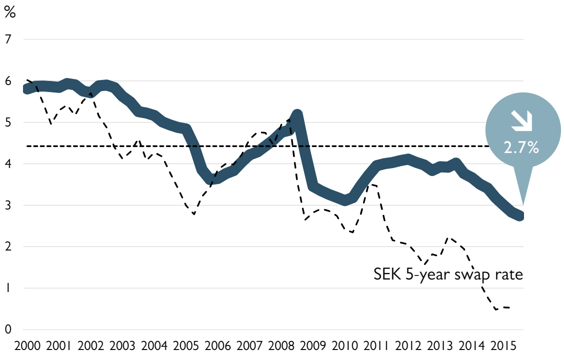
Listed sector Q3 average loan to value[1]



By the end of Q3 2015, the average loan-to-value amounted to 54.3 per cent. Due to a change in the number of surveyed companies, this figure represents a decrease in leverage from the adjusted loan-to-value in Q2 2015 of 55.0 per cent. The continuing decline in loan-to-value was observed among a clear majority of the surveyed companies and is partly due to more conservative lending by the banks.

1 Interest bearing debt on property, excluding cash, divided by property value.

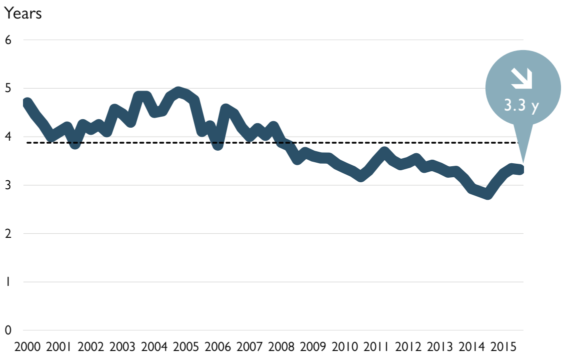
Listed sector Q3 average interest rate[2]



Once again, the average interest rate experienced a slight decline and amounted to 2.7 per cent in Q3 2015. The listed sector continued to experience a reduction in the cost of the debt portfolio, which is in line with the level of underlying interest rates. However, the decrease in the average interest rate in Q3 2015 was significantly less than the decline in the previous two quarters. The slowdown could indicate that the floor will be reached in the forthcoming year.

2 Average interest rate on outstanding debt portfolio as reported by each company.

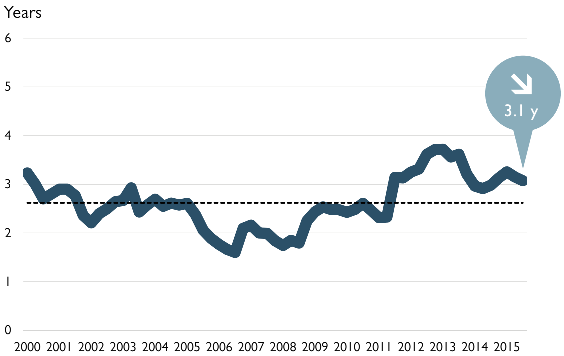
Listed sector Q3 average fixed credit term[3]



In Q3 2015, the average fixed credit term remained relatively unchanged at 3.3 years. The average fixed credit term has reported a rising trend since Q4 2014 and has remained at a level above 3 years since then. The unchanged average fixed credit term may imply that borrowers believed that the refinancing risk related to their loan portfolios was unchanged in the third quarter of 2015.

3 Average maturity referring to interest bearing debt.

Listed sector Q3 average fixed interest term[3]



-------- Average 2000–2015

The adjusted average fixed interest term in Q3 2015 was down slightly and therefore remained at 3.1 years. A vast majority of the surveyed companies lowered their fixed credit term in the third quarter. As in the previous quarter, this indicates that the borrowers expect interest rates to remain low or fall.

3 Average maturity referring to interest bearing debt.

ABOUT THE CREDI INDICES

CREDI is based in part on a set of indices illustrating the aggregate change in leverage, duration and cost of debt for the Swedish listed property sector.

The CREDI Indices are based on publicly available data collected from the financial reports published by the Swedish listed property companies.

Each data point in the CREDI Indices represents the aggregate figure for the Swedish listed property companies. Each company is weighted equally in order to fully reflect the company's individual financing strategy and financing situation. Start date is set as QI 2000.

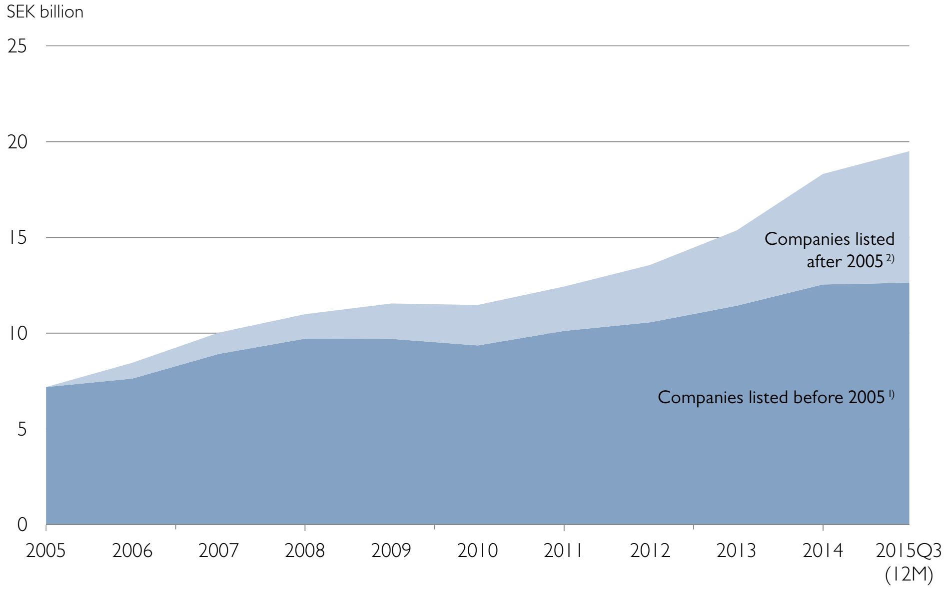
The intention with the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

CREDI – Common shares

Common shares of listed property companies have over the last ten years been valued both higher and lower than the book value of equity. Currently, the common shares of listed property companies are trading at levels giving a historically high premium over the book value of equity.

The property companies listed on Nasdaq OMX Nordic Main Market have steadily increased their net operating income over the past ten years, from approximately SEK 7.1 billion in 2005 to approximately SEK 19.5 billion twelve-months rolling from the third quarter of 2015. This corresponds to an increase in net operating income of 175 per cent. Property companies listed after 2005 account for approximately 35 per cent of the increase. The increase was driven primarily by investments in new and existing properties rather than higher cash flow from existing premises.

Net operating income 12 months rolling for listed property companies on Nasdaq OMX Main Market

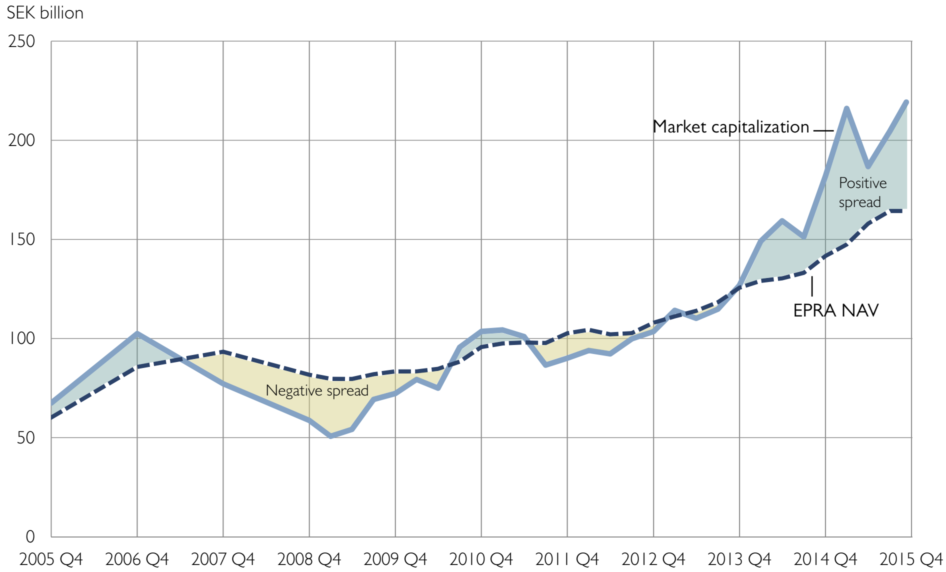


[1] Atrium Ljungberg, Fabege, Hufvudstaden, Castellum, Wallenstam, Wihlborgs, FastPartner, Klövern, Kungsleden and Heba.
[2] Balder, Platzer, Diös, NP3, Catena, Corem, Sagax, Hemfosa and Victoria Park.

Note. Property companies on Nasdaq OMX Nordic Main Market. Pandox and Tribona are not included.

Information regarding the manner in which properties are valued can be observed in both the direct property investment market and in the pricing of shares of listed property companies. Since 2005, the carrying amounts of listed property companies reflect fair values primarily derived from yields observed in the direct property market. The book value of equity can be adjusted to an EPRA NAV that can be seen as a measure of the fair value of net assets, assuming a normal investment property company business model. When the aggregate EPRA NAV is compared with the market capitalization of the listed property companies, a spread is typically observed which can be interpreted as market premium or discount.

Premium or discount – market capitalization as share of EPRA NAV



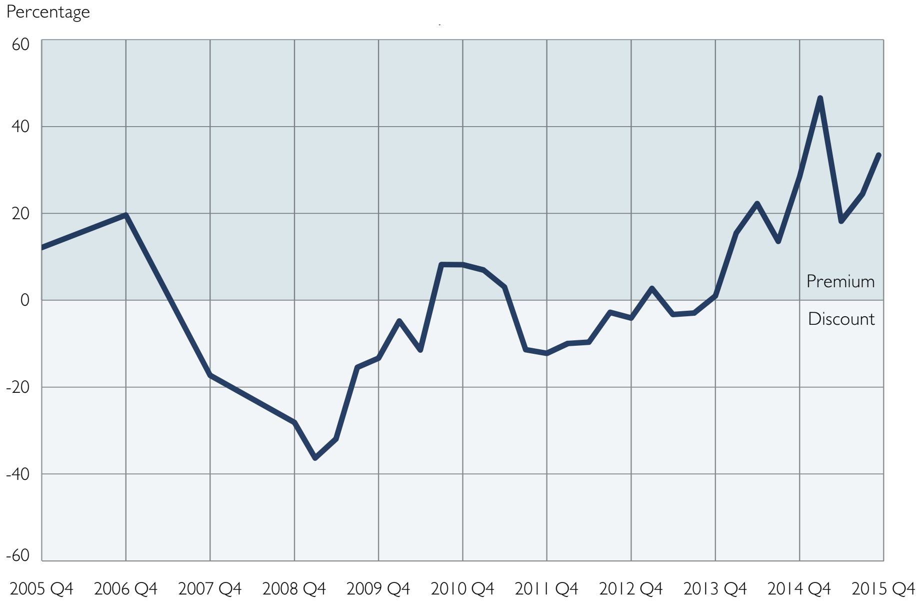
Note. Property companies on Nasdaq OMX Nordic Main Market. Pandox and Tribona are not included.
EPRA NAV includes 5.5 per cent deferred tax.

Source: Catella, annual reports, Nasdaq.

Studying the data over the past ten years, we see that an initial premium turned into a discount during the financial crisis of 2007–2009. Between 2010 and 2013, the market premium and discount were within approximately a +/-10 per cent interval. From 2014 until today, a larger premium of more than 20 per cent can be noted.

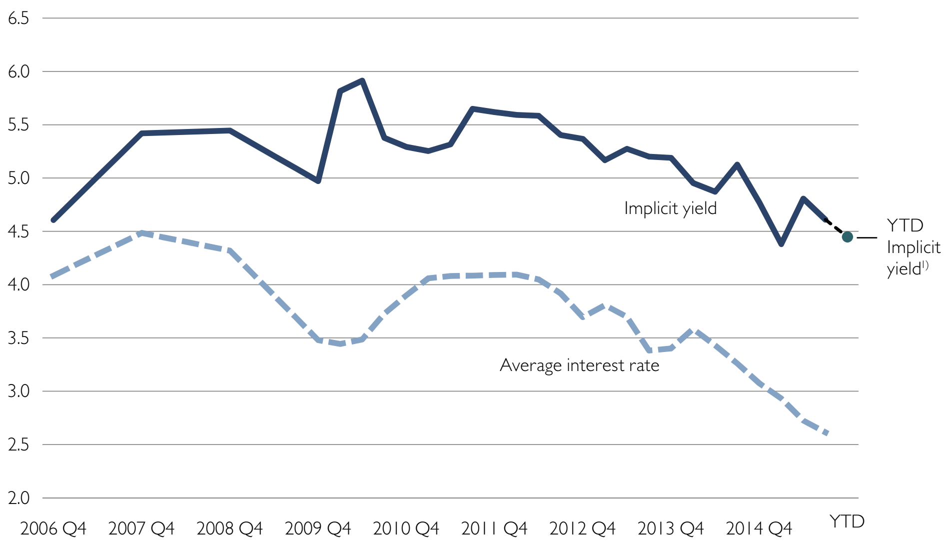
The market premium or discount can be converted to an implicit yield of the properties owned by the listed property companies. The implicit yield is the inverse multiple of how many times the property values correspond to the operating income cash flow. Since 2009, the implicit yield has fallen from approximately 6 per cent to approximately 4.5 per cent. The average interest rate has also declined over this period. As illustrated in the graph to the right, there is a high correlation between the average interest rate and the implicit yield. Using the average interest rate as a proxy for the cost of debt capital together with an assumed leverage of approximately 60 per cent, the required return on equity can be assessed as being quite stable at approximately 7 per cent over the 2011–2015 period. A medium-term reduced cost of debt capital could thus explain the compressed implicit yields observed in the stock market's common shares.

Premium or discount – difference between market capitalization and EPRA NAV, as % of EPRA NAV



Note. Property companies on Nasdaq OMX Nordic Main Market. Pandox and Tribona are not included.
EPRA NAV includes 5.5 per cent deferred tax.

Implicit yield and average interest rate listed property companies on Nasdaq OMX Nordic Main Market



[1)] Market values 2015-12-09 and Q3 2015 EPRA NAV.

Note. Property companies on Nasdaq OMX Nordic Main Market. Pandox and Tribona are not included.
Implicit yield is weighted. Average interest rate is weighted by using the EPRA NAV to Book value of properties-ratio. EPRA NAV includes 5.5 per cent deferred tax.

CREDI – Preference shares

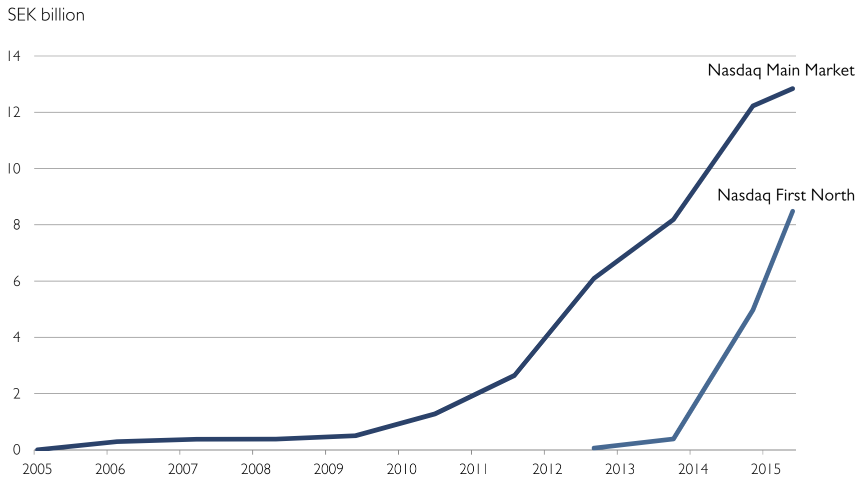
Preference shares have become a popular class of shares in recent years. During the 2012 and early summer 2015 period, preference shares were frequently used by property companies. However, activity was low in autumn 2015 with few new issues.

Since August 2015, activity in the market has been low, with the exception of Hemfosa's private placement of approximately SEK 166 million. In November, Genova Property Group announced that it would issue preference shares totalling SEK 175 million.The dividend is SEK 10.5 per share per year and thus the initial yield is 10.5 per cent. The share was listed on Nasdaq First North 15 December. Genova, a development company, issued at a yield of 10.5 per cent, which is higher than some of its peers, for example, ALM at 7.0 per cent and Prime Living at 8.5 per cent, but lower than Tobin Properties at 11.5 per cent. On average, the preference shares were issued at an initial yield of 7.0 per cent on the Nasdaq Main Market and at 7.7 per cent on First North excluding Akelius*.

Ever since the first issue of preference shares by Sagax in 2006, the property companies on Nasdaq OMX Nordic Main Market have issued preference shares totalling almost SEK 13 billion, with annual dividends of approximately SEK 0.9 billion. Property companies on Nasdaq First North have issued preference shares of SEK 8.2 billion, with annual dividends of approximately SEK 0.6 billion. On the Main Market, preference shares are traded at about 6.3 per cent, having initially been issued at around 7 per cent.

On First North, preference shares are traded at a greater span from 6.7 per cent up to 10.7 per cent and, unlike the Main Market, usually slightly higher than the price at which they were issued. Overall, the yields on market cap on preference shares increased in 2015 compared with 2014, on both the Main Market and the First North. The relatively low market activity and the increase in investors' yield requirements on preference shares reflect the overall financing and stock market volaitility trend of the most recent quarters.

Property companies' total issued volume of preference shares on Nasdaq OMX Nordic Main Market and First North



Property companies with preference shares

Figures in SEK billion unless otherwise stated

Nasdaq OMX Nordic Main Market	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Companies with preference shares/total	0/15	1/15	1/16	1/16	1/16	2/16	3/16	3/16	6/19	7/23	8/23
New issue	-	0.3	0.4	0.4	0.5	0.9	1.9	4.7	6.8	10.9	11.4
Stock dividend (*Sw.* fondemission)	-	-	-	-	-	0.4	0.8	1.4	1.4	1.4	1.4
Total issued volume		0.3	0.4	0.4	0.5	1.3	2.6	6.1	8.2	12.2	12.8
Annual dividend	-	0.0	0.0	0.0	0.0	0.1	0.2	0.5	0.6	0.9	0.9
Annual dividend, % of total issued volume		7.9%	7.9%	7.9%	8.2%	8.3%	8.2%	7.7%	7.4%	7.1%	7.0%
Market value outstanding preference shares	-	0.3	0.4	0.3	0.6	1.4	2.8	6.7	9.6	14.7	14.3
Annual dividend, % of market value		7.2%	7.3%	8.7%	7.3%	7.6%	7.7%	7.0%	6.3%	5.9%	6.3%

Nasdaq First North	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Companies with preference shares/total	0/0	0/0	0/0	0/0	0/0	0/0	0/0	1/1	2/4	6/10	11/21
New issue	-	-	-	-	-	-	-	-	0,3	4,9	8.4
Stock dividend (*Sw.* fondemission)	-	-	-	-	-	-	-	0,06	0,1	0,1	0.1
Total issued volume								0,1	0,4	5,0	8.5
Annual dividend	-	-	-	-	-	-	-	0,0	0,0	0,3	0.6
Annual dividend, % of total issued volume								8,3%	9,4%	6,8%	6.5%
Market value outstanding preference shares	-	-	-	-	-	-	-	0,1	0,4	5,2	7.7
Annual dividend, % of market value								7,0%	8,2%	6,5%	7.1%

*The preference shares on First North were issued at 6.6 per cent. Akelius accounts for SEK 6 billion of the SEK 8 billion issued during the period and, excluding Akelius, the preference shares on First North were issued at an average initial yield of 7.7 per cent.

Note: The Nasdaq OMX Nordic Main Market includes Large Cap, Mid Cap and Small Cap and does not include property companies listed on Baltic. Dagon was delisted 2012 and is not included. Share price year 2015 as per December 10, 2015. Genova market price assumed to be at issue price, SEK 100 per share.

CREDI – Catella's view through the looking glass

The credit cycle has peaked, but strong GDP growth may pull back debt market sentiments into expansionary territory during the first half of 2016.

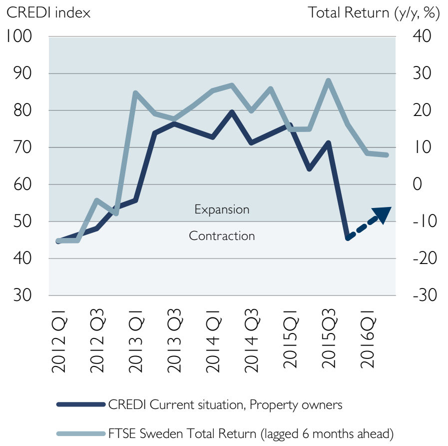
During the fourth quarter, the CREDI index slumped significantly and is now indicating credit contraction. Both the Swedish GDP growth and the total return on the stock market are correlated to the credit sentiments for property owners. Although the stock markets has been turbulent recently, the fall in CREDI is more pronounced than what is motivated by both the stock market and the GDP growth. The Swedish economy is expected to grow above potential in 2016, driven by strong domestic demand and the large inflow on immigrants – factors that may temporary reverse the decline and pull CREDI back into expansion territory during the coming six months.

Although the time series is short, the CREDI index for property owners seems to be a leading indicator for the growth in broad money supply (M3). This is highly relevant for property investors because the broad money supply is correlated with both average property yields and yield spreads between A, B and C locations. In 2015, however, average property yields and yield spread have fallen fast and started to decouple from both broad money supply growth and GDP growth.

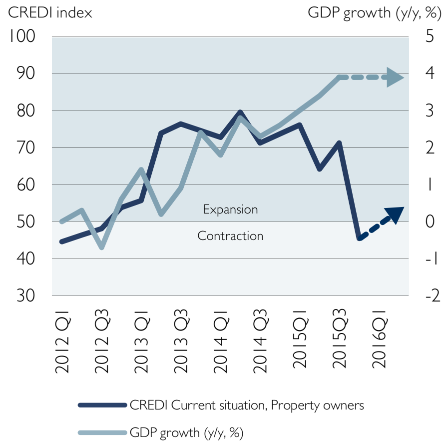
Catella's view is that the credit cycle has peaked. The weakening credit sentiments are well in line with the changes that have been taking place in the financial markets since the summer 2015 – with widening credit spreads between corporate bonds with high and low credit ratings, difficulties in issuing preference shares and corporate bonds, and the rising interest rates on US high yield bonds. Both the average yield and yield spreads between A, B and C locations have bottomed-out and will most likely start to increase during the second half of 2016.

Yields are, however, expected to remain at historically low levels for high-quality properties in attractive locations where rental growth will be strong over the cycles, as real interest rates will remain non-existing for the foreseeable future. In 2016 the timing will be good for disinvestment in secondary locations in major cities as well as in smaller cities whereas liquidity is still good in these locations. Generally, investor demand in these segments is only strong when we are close to the top of the investment cycle.

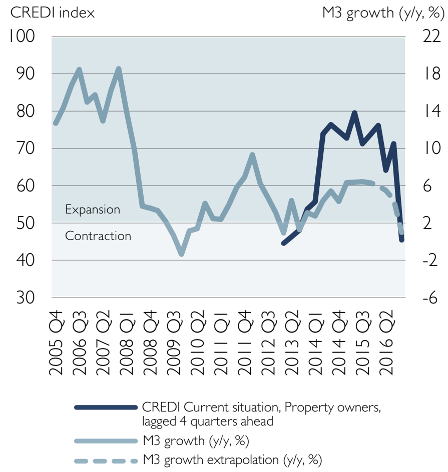
FTSE Sweden and CREDI Current situation for property owners



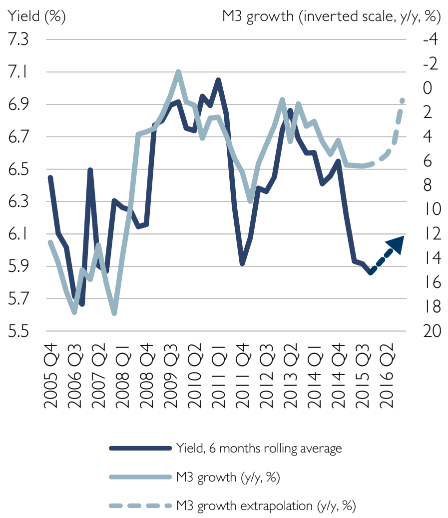
GDP growth and CREDI Current situation for property owners



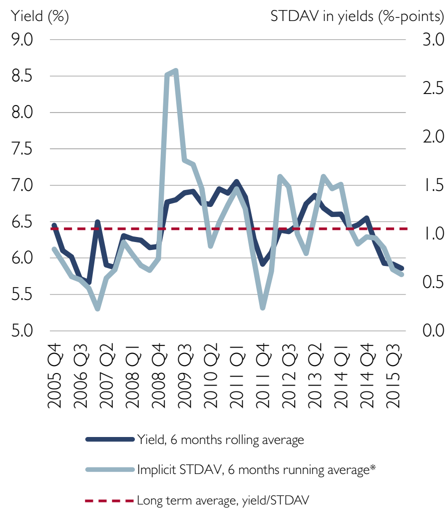
The M3 growth and CREDI Current situation for property owners



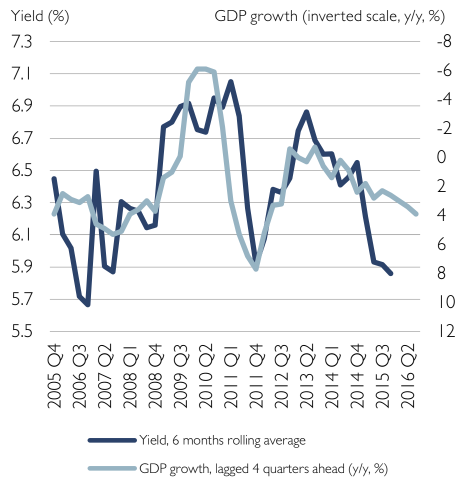
The M3 growth and average yield*



Yields and spreads**



Yields and GDP growth**



Source: FactSet and Catella

* Calculated index based on the standard deviation of yields from historical office and retail transaction, in combination with measures of the over-all market liquidity.
** Yields are based on historical office and retail transactions in Sweden. Yields are either verified or estimated by Catella.

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