CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

CREDI March 2016

Still negative but mixed sentiments

In this March issue of the CREDI survey, the Main index fell another 2.7 points to 41.2. In line with the previous results in the December survey a decline was observed in both the Current situation and Expectation indices. Thus, the Main index as well as its two underlying indices are all still below the 50.0 turning point. This suggests that the polled lenders and borrowers continue to believe that the market has been in the zone of credit contraction over the past three months and will continue to be so in the coming three months.

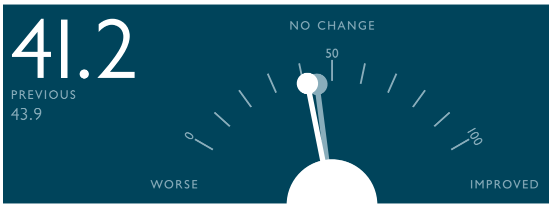
With a further decrease of the CREDI Main index level, this March survey indicates that the participants in the survey believe in a weakened access to financing. The weakening index should be viewed against the backdrop of the relatively positive development in the Swedish economy but also weakened risk appetite in financial markets. While the economy has been boosted by increased construction and job growth the downward pressure on inflation with soft monetary policy continues. Downside risks have now been priced into both debt and equity instruments to a larger extent than 12 months ago. The property companies' preference shares have been revalued over the last 12 months. Activity in the primary market has slowed with few new issues and yields in the secondary markets have risen.

The CREDI Main index as well as its two components; Expectation and Current situation indices, dropped and consequently remain at a level below the 50.0 turning point in this March survey. The Main index dropped by 2.7 index points to 41.2. This is however a fairly moderate reduction compared to the decline experienced in the previous December survey by 12.7 points.

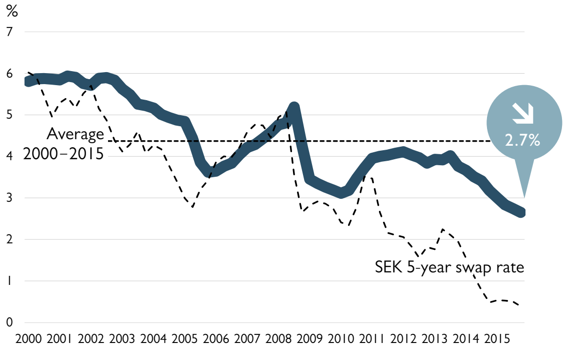
This March survey is characterized by a diverging trend between the polled lenders and borrowers. The 2.7 index points drop in the Main index is primarily driven by a more cautious view from the bank sector. The Main index components for the polled banks experienced a significant decline and both remain firmly below the 50.0 turning point. In contrast, the polled real estate companies instead believe in improved access to financing in both the past three months and the next three months. This means that the Current situation and Expectation indices for property owners are both above the 50.0 turning point.

In the fourth quarter of 2015 a number of the previous trends observed in the CREDI Indices persisted. The average interest rate fell once again to 2.7 per cent. This represents an over 34 per cent decrease in the average interest rate, from 4.0 per cent in Q2 2012 to the current 2.7 per cent during Q4 2015. Despite an increase in the average loan to value, a majority of the Swedish listed property sector in fact decreased their leverage in Q4 2015. This results from a significant increase in the property values of the listed sector as well as the more conservative lending by banks.

CREDI Main index

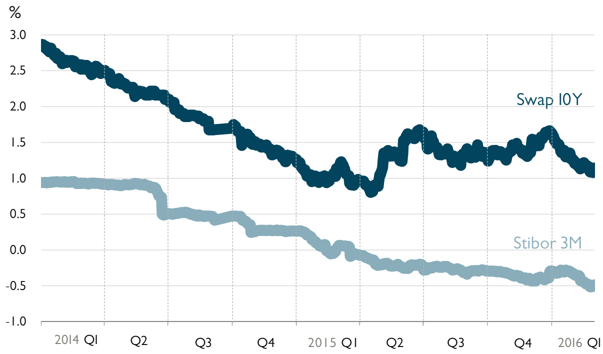


CREDI Indices – Q4 Average interest rate*



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

Swedish key interest rates, 2014–2016



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

The Main index once again dropped by 2.7 points to 41.2 in this March survey indicating a slightly weakened financing climate. Consequently, the Main index as well as the Current situation and the Expectation indices remain at a level firmly below the 50.0 turning point. However, there is a diverging trend observed between the polled lenders and borrowers in the March survey. In contrast to the surveyed banks, the property owners instead believe in an improved access to financing in both the past three months and the next three months.

Main index components

In line with the previous December survey, the Main index remains below the 50.0 turning point and has now further dropped to 41.2 (43.9) in this March survey. This time however the index fell by a moderate 2.7 index points compared to the 12.7 index point drop observed in the previous survey. The contraction was observed in both the Current situation index and the Expectation index, whereas the latter experienced the largest drop. The Current situation index fell by 1.3 index points to 41.0 and the forward-looking index fell by 4.1 index points to a record-low 41.4.

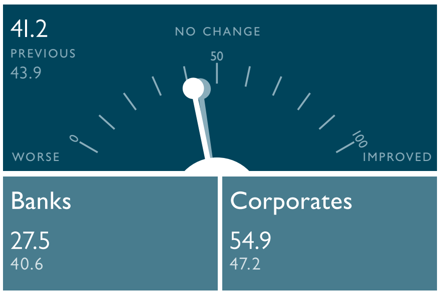
This March issue of the CREDI survey displayed a diverging trend between the polled lenders and borrowers. In general, the polled lenders have a more negative outlook in the CREDI survey. However, in the previous December survey both banks and property owners believed in a weaker financing climate which was indicated by index levels below 50.0. In this March survey, the decline in the Main index level is driven by the cautious lenders. In contrast, both the Current situation index and Expectation index for property owners increased by 11.5 and 3.9 index points respectively and accordingly, both are now above the 50.0 turning point.

Sub-indices

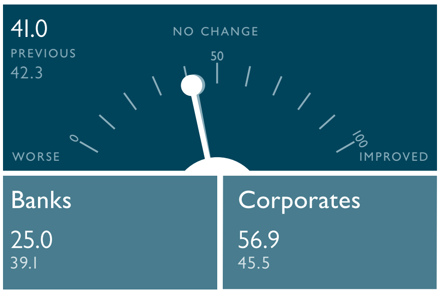
All of the underlying Expectation sub-indices experienced a decline in this March issue of the CREDI survey and are now below the 50.0 turning point. The Expectation Leverage sub-index displayed the largest reduction and fell by 7.6 index points whereas the Expectation Duration sub-index dropped by 3.7 index points to 48.6.

The Current situation sub-indices are in contrast either well-below the 50.0 turning point or slightly above 50.0 in this March survey. A decrease was experienced in both the Current Credit Availability and Credit margin sub-index to 33.3 and 22.2 index points respectively. However, the Current Leverage and Duration sub-indices increased by 10.4 and 1.0 index points respectively and are slightly above the 50.0 turning point.

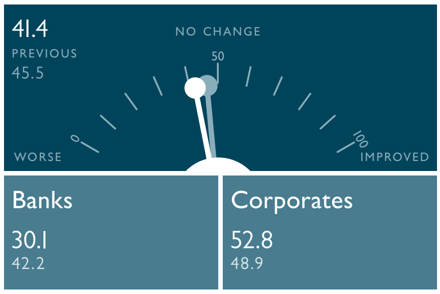
CREDI Main index



Current situation



Expectation



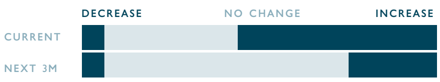
CREDI Sub-indices

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

LEVERAGE

CREDIT MARGINS



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.

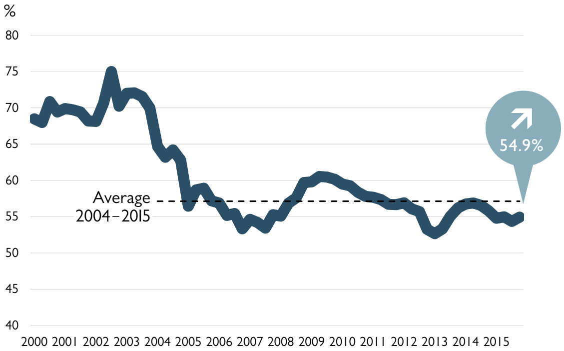
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. The final index figure represents an average of all weighted answers. Weights are applied such that a “no change”-answer equals 50. Consequently, 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

The CREDI Indices for the reported data from the last quarter of 2015 show a reversal of the trend of decreasing leverage and average loan-to-value. However, the average interest rate continues to decline and is now 2.7 per cent for the surveyed companies.

Listed sector Q4 average loan to value[1]

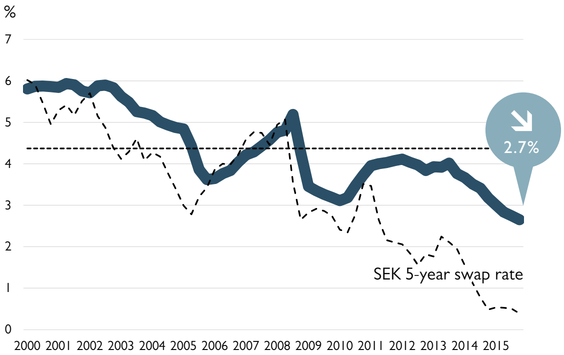


The adjusted average loan-to-value increased and amounted to 54.9 per cent by the end of 2015. The leverage has in general followed a decreasing trend since Q2 2014 and the loan to value has moved away from the historical average. The trend of more conservative lending by banks followed by a significant increase in property value has led to a decline in leverage for a majority of the listed property sector.

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

Please note that Catena has made a significant increase of their interest-bearing debt due to the acquisition of Tribona. This has had a significant effect on average loan to value.

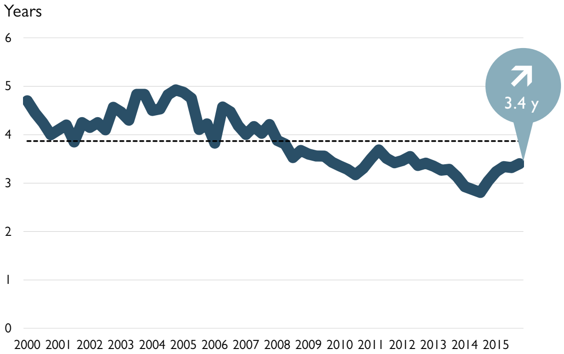
Listed sector Q4 average interest rate[2]



The average interest rate for the listed sector continued to decline in Q4 2015 and amounted to 2.7 per cent Q4 2015. The average interest rate has, with a few exceptions during these years, experienced a significant fall since the second quarter of 2012. In total the reduction amounts to 34.3 per cent from 4.0 per cent to the current 2.7 per cent between Q2 2012 and Q4 2014. The continued decline is however in line with the underlying interest rates that remain at considerably low levels.

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

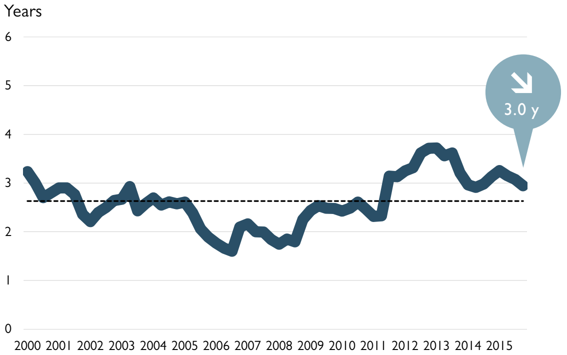
Listed sector Q4 average fixed credit term[3]



The average fixed credit term in Q4 2015 increased slightly to 3.4 years and thus continued the increasing trend observed since Q4 2014. The increase in credit term is still below the historical average of 3.9 years but has gradually closing in during the past year. The increasing average fixed credit term suggests that the listed sector expects the refinancing risk to increase in the near future.

3 Average maturity referring to interest bearing debt.

Listed sector Q4 average fixed interest term[3]



-------- Average 2000–2015

In Q4 2015 the average fixed interest term once again decreased to 3.0 years. The trend was observed among a clear majority of the listed property sector and the average fixed interest term has been slowly decreasing since the second quarter of 2015. A decreasing fixed interest term implies that the surveyed companies expect interest rates to stay or drop in the near future.

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.

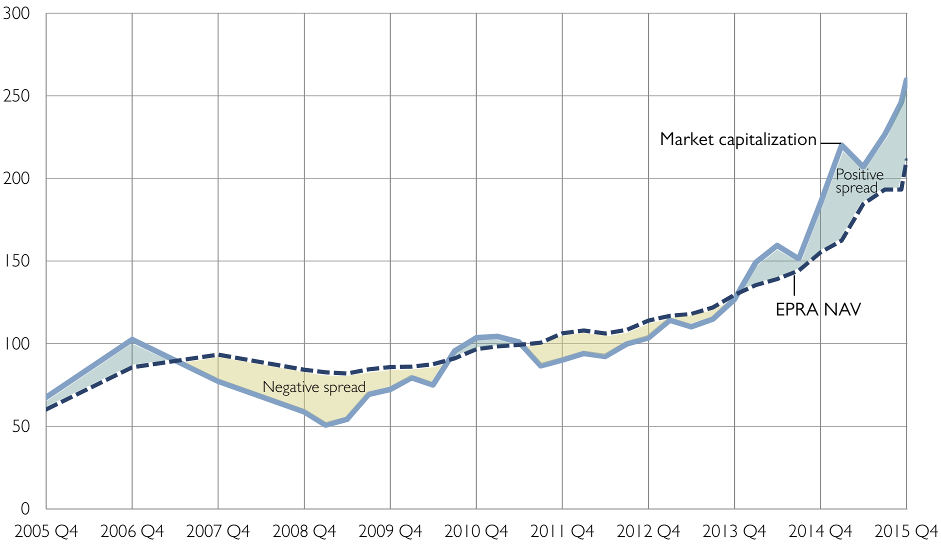
The intention with the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

CREDI – Common shares

Despite the turbulence on the Swedish stock market, the listed property sector has been able to resist some of the volatility experienced by the rest of the market. However, due to a strong increase in EPRA NAV the market premium dropped to 20 per cent from 27 per cent in this issue of the CREDI report.

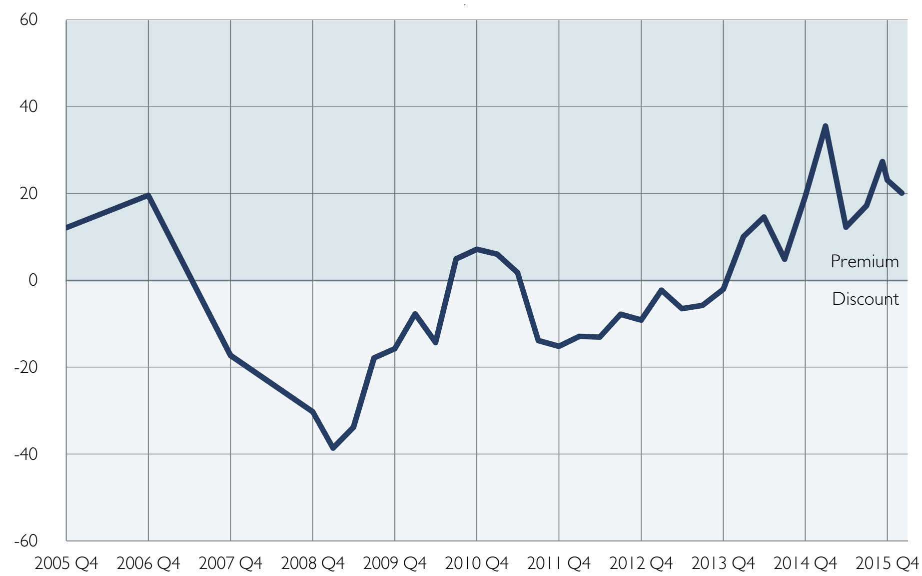
The spread between the aggregate EPRA NAV of the property companies on Nasdaq Main Market compared to the market capitalization has represented a market premium since the fourth quarter of 2013. This market premium suggests that the stock market value properties higher than the direct property market. In a historical perspective, the current positive spread of around 20 per cent is relatively high when viewed over the last ten year period. The positive premium has remained even as yields in the direct property transaction market have continuously been compressed over the last years.

Premium or discount – market capitalization as share of EPRA NAV



Note. Property companies on Nasdaq OMX Nordic Main Market. Tribona is not included. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

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



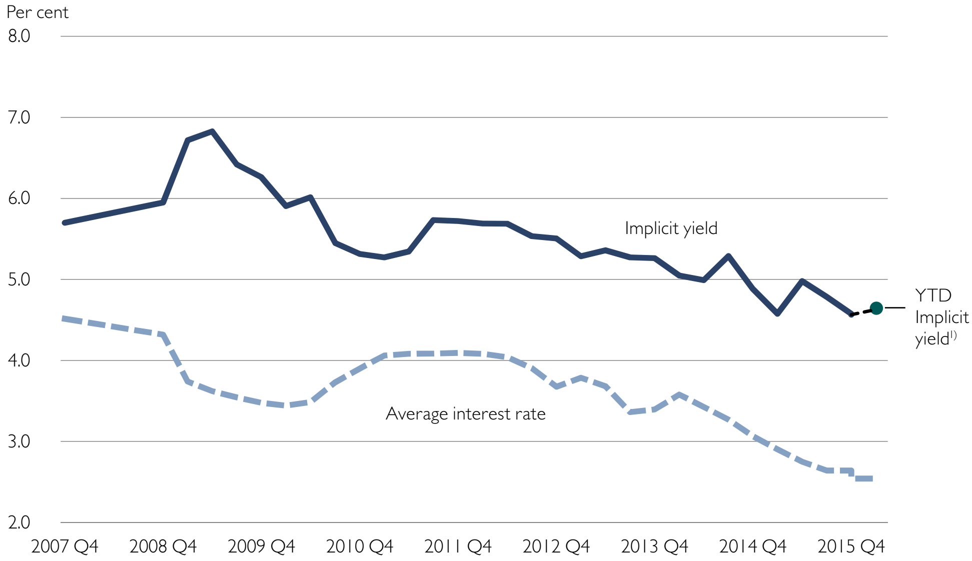
Note. Property companies on Nasdaq OMX Nordic Main Market. Tribona is not included. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

Since the previous CREDI report in December 2015, the listed property companies have reported full year figures for 2015 and the stock market has been volatile overall. However, the listed property companies have held up quite well. As of March 04, 2015, the market value of the publicly traded common shares has increased slightly by 3 per cent compared to previous CREDI with data from December 09, 2015. The strong development towards the end of 2015 has made up for the more volatile and negative development in the beginning of 2016. However, the EPRA NAV presented in the Q4 reports have increased by approximately 9 per cent. Both the new reported figures and the stock market volatility have affected the market premium of listed property companies. The net effect is a reduction of the market premium by approximately 7 percentage points to 20 per cent since the previous CREDI report.

Source: Catella, annual reports, Nasdaq.

The relationship between the average interest rate of the listed sector and the implicit yield is among other factors derived from the underlying market interest rates. The market interest rates by default affect the direction of the yield levels as well as the average interest rate of the Swedish property sector. In Q4 2015 the implicit yield remained relatively unchanged at 4.6 per cent, only a minor increase was observed. The average interest rate of the Swedish property sector continued to decline in the fourth quarter of 2015. The spread between the implicit yield and the average interest rate has historically varied from closely to 300 bps to 120 bps. The current spread is approximately 210 bps.

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



[1)] Market values 2016-03-04 and Q3 2015 EPRA NAV.

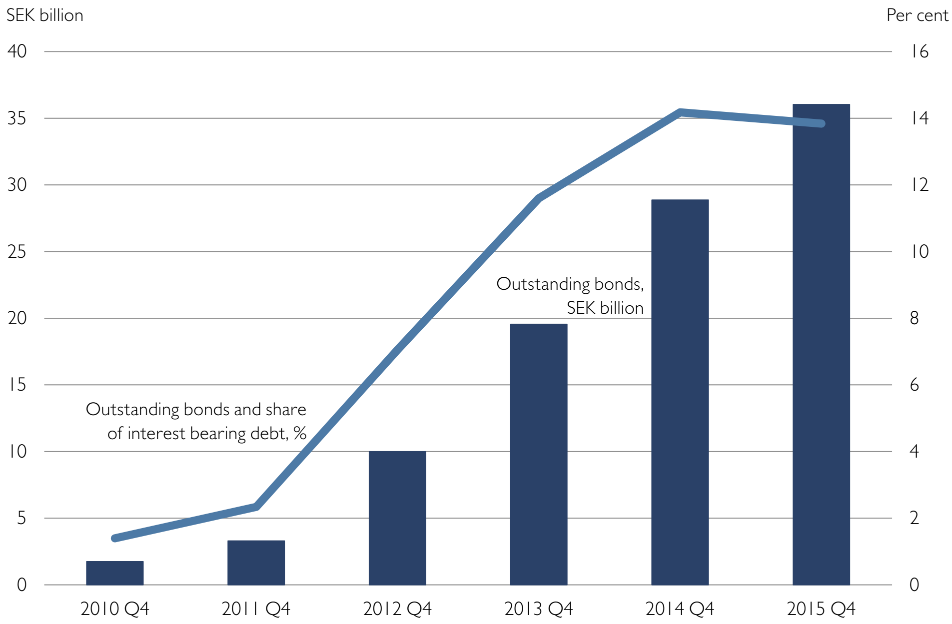
Note. Property companies on Nasdaq OMX Nordic Main Market. Tribona is not included. Implicit yield is weighted. Average interest rate is weighted by using the EPRA NAV to Book value of properties-ratio. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

CREDI – Bonds

The trend of bonds increasing its share of interest bearing debt has come to a halt.

Corporate bonds have been increasingly used by the listed property sector. In 2010, bonds were only used by a small share of the listed companies. Towards the end of 2012 corporate bonds began to make up a significant share and accounted for approximately 7 per cent of the interest bearing debt. The trend of increasing use of bonds continued in 2013 and in the first half of 2014 unsecured and secured bonds comprised almost 14 per cent of the interest bearing debt. Currently the amount of outstanding bonds for the listed property sector amounts to SEK 36 billion which is 13.8 per cent of the interest bearing debt for the same companies.

Outstanding bonds

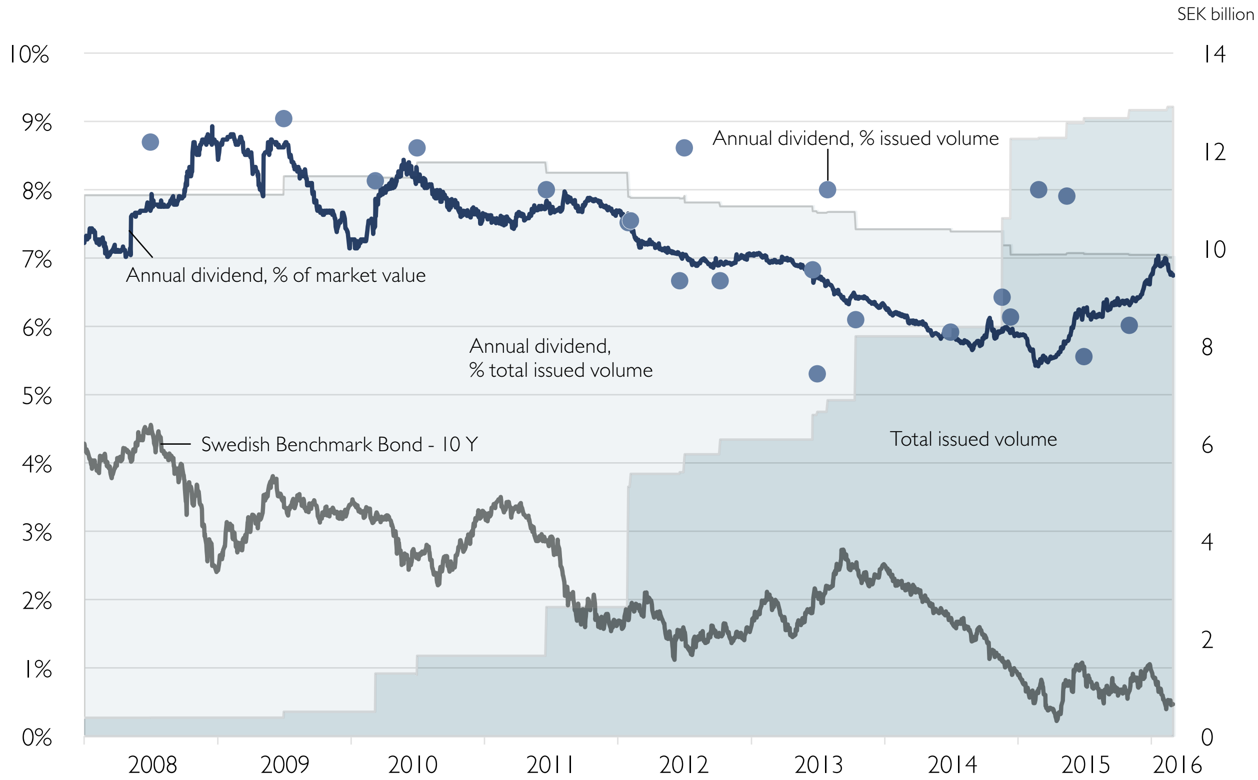


Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Preference shares

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

Property companies' preference shares on Nasdaq OMX Nordic Main Market



Preference shares have represented the newest form of debt capital for the property companies' ordinary shareholders. The advantages have included ability to roll up interest and no strict obligation but rather an option for the property company to redeem the shares at par value or possibly with a premium. Dividends are typically fixed and the overall terms of issued preference shares more resemble debt than equity – unless viewed from a more senior lender's perspective where it constitutes an additional risk buffer.

Total issued volume of preference shares on Nasdaq OMX Nordic Main Market currently amounts to more than SEK 12 billion. There was a significant jump in the total issued volume between 2014 and 2015 and preference shares became an increasingly popular financing instrument.

Now, the financial market has priced in downside risks to a larger extent compared to 12 months ago. Consequently the Swedish property companies' preference shares have been revalued. Preference shares were historically traded at 7 per cent in the beginning of 2013 but the annual dividend as a percentage of market value then decreased to around 6 per cent. Also, several new issues were done at the 6 per cent level. Now, since the end of 2015 preference shares of property companies on the Nasdaq Main Market are once again trading at 7 per cent. Now, the fact that the medium to long-term interest rates have if anything fallen and liquidity has held up during the period suggests that the market risk premium has increased.

Activity in the primary market has been slow since the summer of 2015 with few new issues of preference shares observed. However, in February 2016 Oscar Properties announced a Class B preference share. The terms were unique in that the holders' of the preference shares from year 2017 have a right to request the shares to be redeemed by the issuer. This should mitigate the risk of an immediate loss in value of the preference shares as a consequence of interest rates shooting up. It also provides a helpful exit should liquidity on the secondary market dry up. The issuer also has an option to increase the dividend per share and thus has a built-in lever to ensure the instrument remains attractive to hold. The announcement in February 2016 of a successful book building of SEK 200 million can be interpreted as a continued interest in the primary market for preference shares and especially for shares with more balanced terms.

CREDI – Catella's view through the looking glass

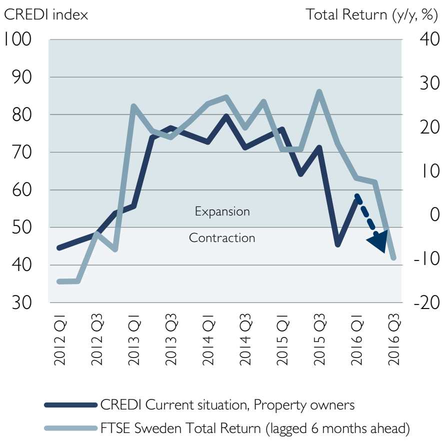
Weaker credit sentiments and lower GDP growth will push up average yields – but prime yields will remain at historically low levels.

During the first quarter 2016, the CREDI index for property owners bounced back from contraction territory into expansion. There is, however, a clear difference between the development for property owners and for banks. While the credit sentiments have recovered for the listed property companies, the banks' credit sentiments fell deeper in contraction.

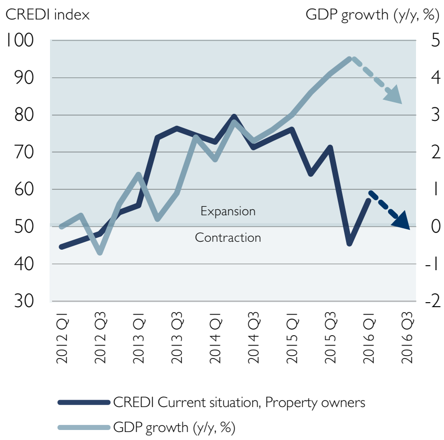
Both the Swedish equity market and the GDP growth are correlated to the CREDI index. The equity market has been turbulent since the start of 2016, and the recent year's decline in the CREDI index is well in line with the overall total return development on the equity market. During recent quarters, however, the CREDI index has decoupled from the GDP growth – which grew at historically strong 4.1 per cent in 2015, driven by household consumption, investments and a large inflow on immigrants. There are plenty to suggest that the global economy will slow down in 2016 and we are now seeing signs that growth is weakening in the euro area and Japan – and eventually also in Sweden. This at a time when fiscal policy is already highly expansionary and the scope for further monetary stimulus is limited. Lower GDP growth will probably push CREDI for property owners back into contraction territory during the coming 6–12 months.

Catella's view is that the credit cycle peaked during the autumn 2015. The weakening credit sentiments during the last 6 months are well in line with the changes on the financial market since the summer 2015 – with widening credit spreads and difficulties in issuing preferred shares and corporate bonds. The average yield on the property market is strongly correlated to the GDP growth, and a weaker economy will lead to higher average yields. A significant portion of this increase will take place through a higher yield spread between A, B and C locations and lower transaction volumes in secondary locations. However, low or negative bond yields, falling commodity prices and a volatile stock market will make high-quality properties in Swedish growth cities highly attractive for investors during coming years – and especially institutional investors will be active on the market and keep prime yields at historically low levels for the foreseeable future.

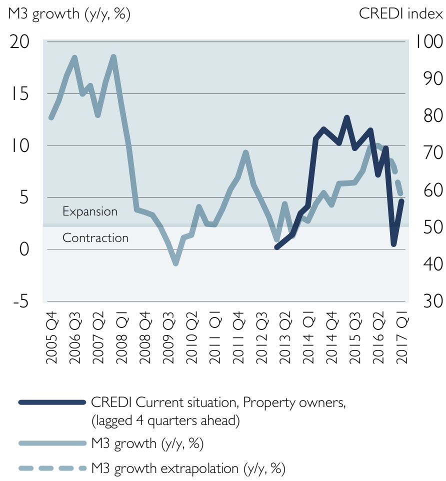
FTSE Sweden and CREDI Current situation for property owners



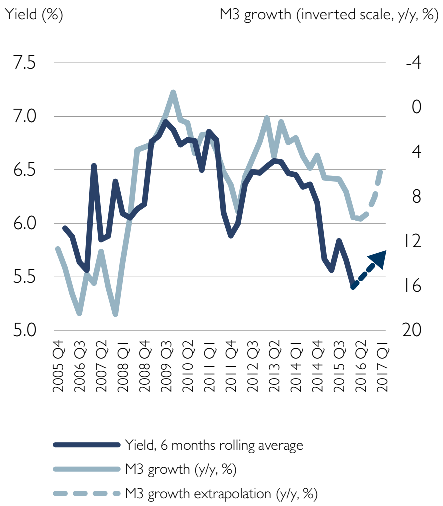
GDP growth and CREDI Current situation for property owners



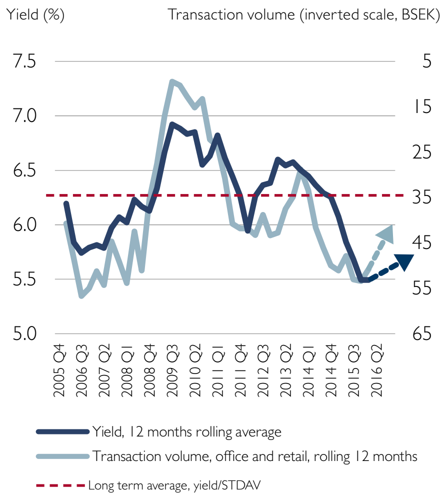
The M3 growth and CREDI Current situation for property owners



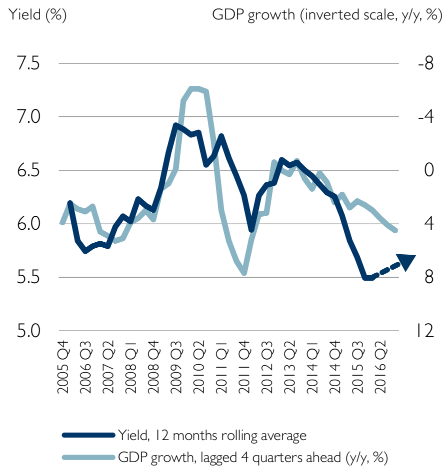
The M3 growth and average yield*



Yields and transaction volume*



Yields and GDP growth*



Source: FactSet and Catella

* Yields are based on historical office and retail transactions in Sweden. Yields are either verified or estimated by Catella.

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Catella is a European financial advisor and asset manager. In Sweden, Catella is a leader on market for advisory services in connection with property transactions and property-related services within debt and equity capital markets. We have offices in Stockholm, Gothenburg and Malmö.

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