



CREDI December 2016

# Banks and corporates agree: credit margins have increased

In the December issue of CREDI there are noticeable improvements in the property debt financing market, with the Main index increasing from 42.5 to 44.4. However, the market is still in contraction, and banks and property companies agree that credit margins are increasing.

**THE CREDI MAIN INDEX IMPROVED DURING THE PAST THREE MONTHS**  
Although the property debt financing market is still in contraction, there has been an improvement in the CREDI Main index, which has increased from 42.5 to 44.4. In addition, the December survey has the strongest consensus between banks and property companies in the history of CREDI.

**LONG-TERM INTEREST RATES ARE UP**  
The 5-year and 10-year swaps have increased slightly, as has the 10-year Swedish benchmark bond. Nevertheless, short-term interest rates are still low.

**HIGHER CREDIT MARGINS**  
The Credit Margins sub-indices have worsened considerably in the December survey, both with regard to the current situation and expectations for the coming three months. This means that banks and property companies agree that credit margins have increased and will increase further in the next quarter.

**MARKET PREMIUMS WERE UP IN THE THIRD QUARTER...**  
During the third quarter, the market capitalisation of listed property companies increased considerably, which caused market premiums to increase by nearly 50 per cent.

**...BUT HAVE SINCE FALLEN**  
The entire increase in property companies' market capitalisation has evaporated in the past two months, which has caused market premiums to fall.

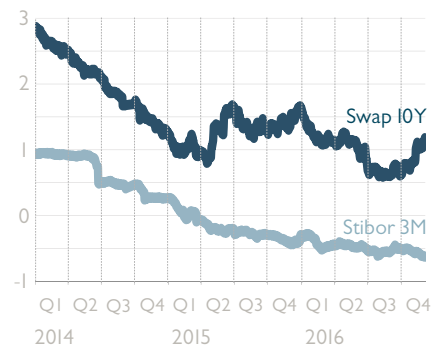
**SLOW QUARTER FOR BONDS**  
Following a record quarter where the volume of outstanding bonds increased by more than SEK 6 billion, this quarter has seen few issues of corporate bonds in the property industry.

**AND PREFERENCE SHARE YIELDS HAVE INCREASED**  
The average dividend to market price for property-related preference shares has increased from 6.04 to 6.52 per cent.

CREDI Main index



Swedish key interest rates, 2014–2016. Per cent



Loan-to-value Q3 average	54.3%	Interest rate Q3 average	2.6%	Fixed credit term Q3 average	3.0 y	Fixed interest term Q3 average	2.7 y
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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](http://catella.se/CREDI)

# The CREDI Survey

The CREDI Main index increased from 42.5 to 44.4 in the December survey. This means that banks and property companies have a more positive view of the market than in September, but the debt financing market is still in contraction.

## Main index components

The CREDI Main index has been below the 50.0 turning point for the past four surveys. However, the December survey exhibits the strongest Main index figures since September 2015. The surveyed property companies and banks still believe that the debt financing market is in contraction, but they view the market more positively than they did in the four previous surveys.

Similar to previous surveys, property companies have a more positive view of the debt financing market than the banks. This is true both with regard to the current situation and to expectations for the coming three months. Nevertheless, the consensus between property companies and banks is stronger than ever before. Having differed

by as much as 27.3 index points in the March survey, the spread between property companies and banks in the Main index is currently at 2.9 index points. This is the lowest spread in the history of CREDI, which means that we have the strongest consensus between property companies and banks since May 2012, when the first CREDI survey was conducted.

As has been the case for the past four surveys, the surveyed property companies and banks have a more optimistic view of the future than of the current situation. This is reflected in the Expectations index, which is 3.6 index points higher than the Current Situation index. In fact, the increase in the Main index is to a great extent the result of improvements in the Expectations index.

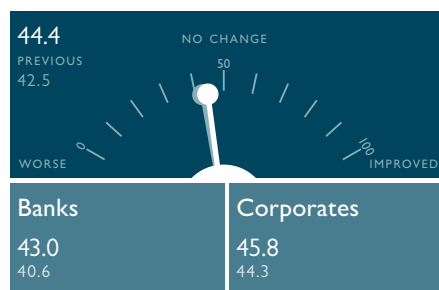
## Sub-indices

Looking at the underlying sub-indices, we see a pattern where some sub-indices have a considerable negative impact on the Main index, while other sub-indices have a positive or neutral impact.

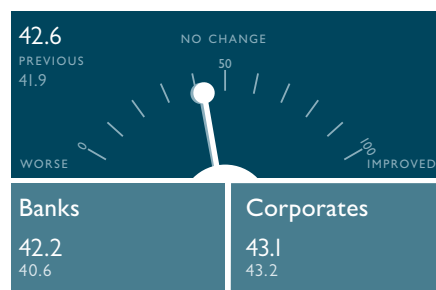
For example, the Current Credit Availability sub-index has decreased since the September index and is currently at 37.8, while both Credit Margins sub-indices have worsened considerably. In fact, increasing credit margins is the main reason why the CREDI Main index is still below the 50.0 turning point.

On the other hand, both Duration sub-indices are above the 50.0 turning point, while both Leverage sub-indices are just slightly below the 50.0 turning point.

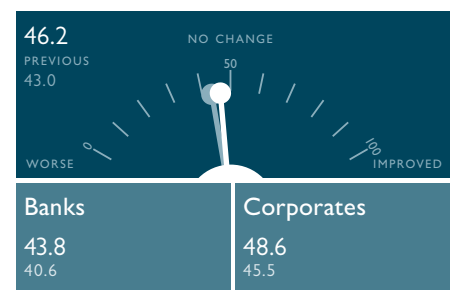
## CREDI Main index



## Current situation



## Expectation



## CREDI sub-indices

The 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. This part of the indicator is called the CREDI survey.

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. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 50 index points. Consequently, the turning point in

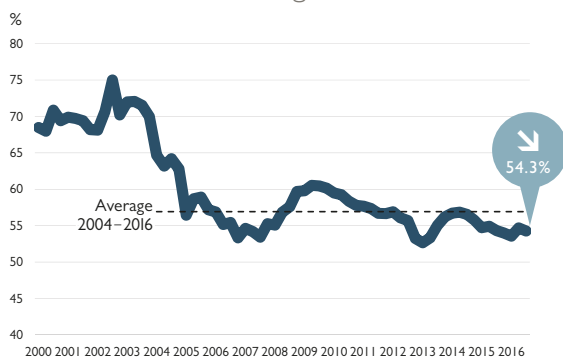
sentiment is 50 and any reading below this level indicates more difficult financing conditions while any reading above indicates less difficult financing conditions.

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

All of the four CREDI Indices fell during the third quarter of 2016. The trends of falling interest rates, fixed credit terms and fixed interest terms continue, while average loan-to-value decreased following a relatively large increase in the second quarter.

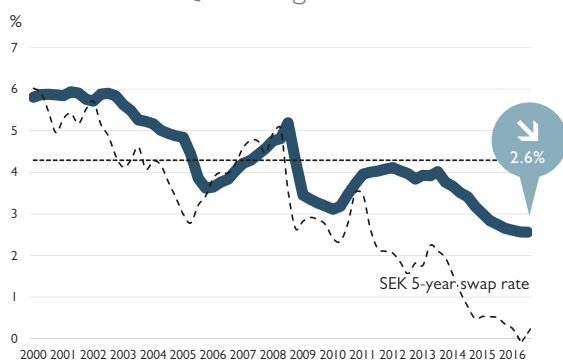
Listed sector Q3 average loan-to-value<sup>1</sup>



During the third quarter of 2016, the listed property companies' property value increased by 3 per cent, while their interest-bearing debt increased by 2 per cent. Accordingly, the average loan-to-value decreased slightly from 54.7 per cent to 54.3 per cent. Although all the listed property companies have seen increased property value during the third quarter, about a third of the companies have reduced their interest-bearing debt.

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

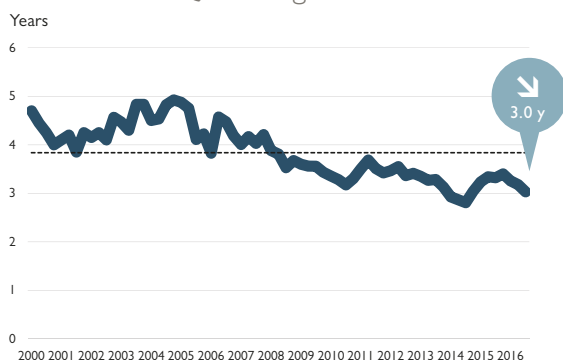
Listed sector Q3 average interest rate<sup>2</sup>



The average interest rate has been decreasing every quarter for the past three years. However, the third quarter of 2016 saw the smallest decrease yet. The average interest rate fell by a miniscule 0.01 percentage points, from 2.57 per cent to 2.56 per cent. Approximately one quarter of the listed property companies increased their average interest rate, while slightly less than half of the companies saw reduced average interest rates in the third quarter.

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

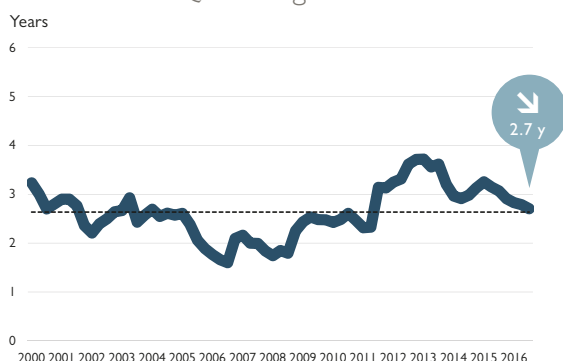
Listed sector Q3 average fixed credit term<sup>3</sup>



In the third consecutive quarter with reduced credit terms, the average fixed credit term among listed property companies decreased from 3.2 years to 3.0 years. The falling average fixed credit term is a possible indication that property companies do not expect refinancing risk to increase in the near future. Indeed, only one fifth of the surveyed companies extended their fixed credit term during the third quarter of 2016. As such, the average fixed credit term is currently far below the historical average of 3.8 years.

3 Average maturity referring to interest-bearing debt.

Listed sector Q3 average fixed interest term<sup>4</sup>



The average fixed interest term among listed property companies decreased from 2.79 years to 2.71 years during the third quarter of 2016. This marks the sixth consecutive quarter with decreasing fixed interest terms, and the industry average is fast approaching the historical average of 2.64 years. The falling fixed interest terms suggest that the property companies expect interest rates to decrease or remain at the current rate in the near future.

4 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 Swedish listed property companies.

Each data point in the CREDI Indices represents the aggregate figure for Swedish listed property companies. Each company is weighted equally in order to fully reflect the company's individual financing strategy and financing situation. The start date is set as Q1 2000.

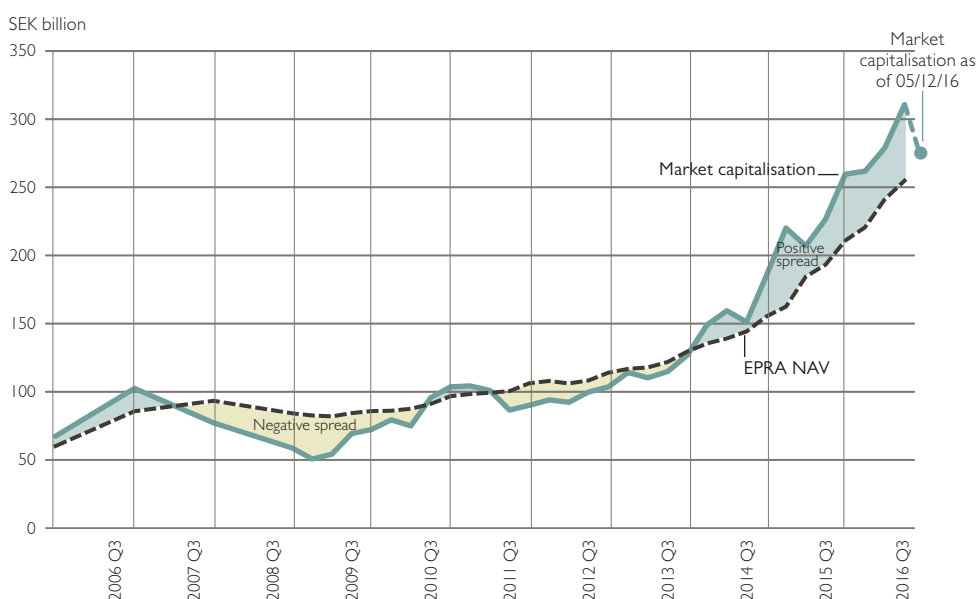
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

# CREDI – Common shares

In the third quarter of 2016, property companies listed on Nasdaq OMX Nordic Main Market increased their market capitalisation considerably, resulting in higher market premiums and lower implicit yields. However, as the market capitalisation of listed property companies has fallen considerably in recent months, we are about to see shrinking premiums and higher implicit yields.

During the third quarter of 2016, the market capitalisation of property companies on Nasdaq OMX Nordic Main Market increased from SEK 279 billion to SEK 311 billion, while the companies' EPRA NAV increased from SEK 241 billion to SEK 255 billion. Accordingly, the market premium for listed property companies increased by nearly 50 per cent, from SEK 38 billion to SEK 56 billion. It is worth noting, however, that the market capitalisation of listed property companies has decreased considerably since the end of the third quarter. As of 5 December 2016, market capitalisation is at SEK 277 billion, which is slightly lower than at the end of the second quarter. Consequently, market premiums are likely to have gone down at the end of the fourth quarter.

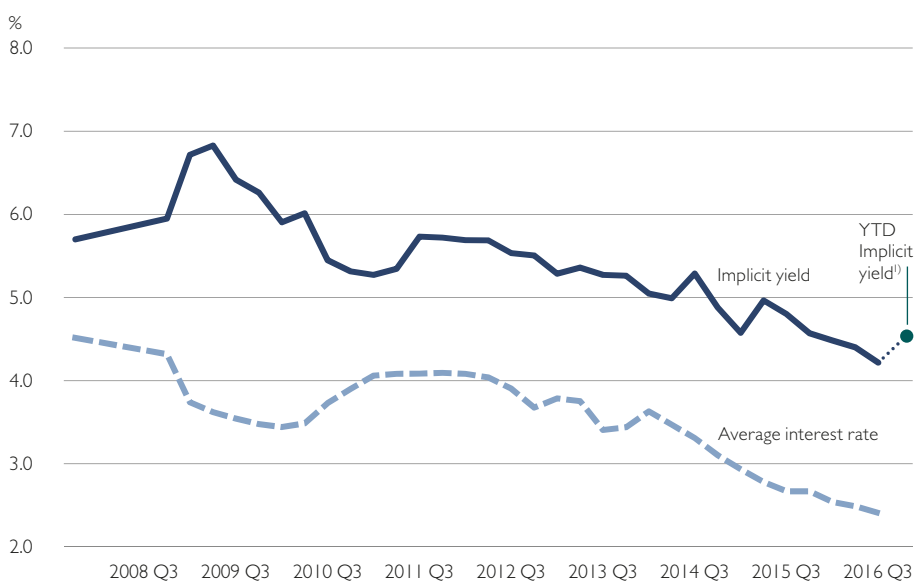
Premium or discount – market capitalisation as share of EPRA NAV



Note. Property companies on Nasdaq OMX Nordic Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

The implicit yield of listed property companies has decreased from 4.40 per cent in the second quarter of 2016 to 4.22 per cent in the third quarter of 2016. This was the fifth consecutive quarter with a falling average implicit yield, which means that the stock market has been valuing property companies' net operating income increasingly higher over the past year and a half. However, the year-to-date implicit yield suggests that this trend is about to come to a halt, as market capitalisation has fallen considerably since the end of the third quarter. As such, the year-to-date implicit yield is noticeably higher at 4.48 per cent, which is the same yield as in the first quarter of 2016. In other words, the implicit yield might be noticeably higher in the fourth quarter of 2016.

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

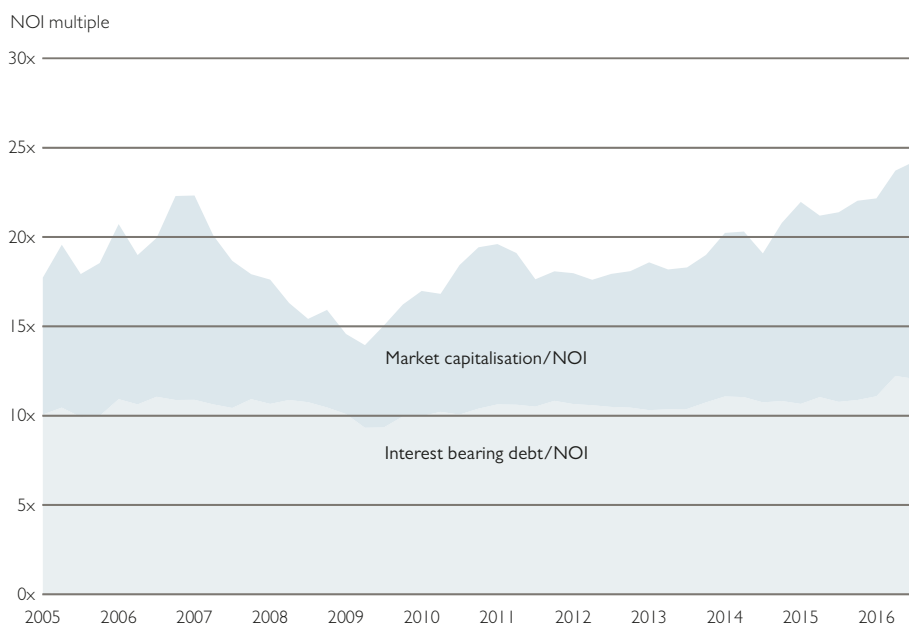


<sup>1)</sup> Market values 05/12/2016 and Q3 2016 EPRA NAV.

Note. Property companies on Nasdaq OMX Nordic Main Market. 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.

In this issue of CREDI, the graph showing interest-bearing debt and market capitalisation in relation to NOI has been expanded to include data from 2005 onwards. Consequently, it is possible to see how the stock market and banks reacted to the financial crisis by studying how they valued the NOI of listed property companies. For example, in 2007 the stock market valued property companies at 11.4 times their NOI, while interest-bearing debt was approximately 10.9 times NOI. However, while market capitalisation fell to 4.5 times NOI, the debt never fell below a multiple of 9.3. In other words, the stock market has been significantly more volatile and increased their valuation from 4.5 times NOI in 2009 to 12.2 times NOI in Q3 2016. Banks have increased their lending in tandem with property companies' cash flow development, which has resulted in a lower LTV (as property value has increased faster than NOI).

Interest-bearing debt and market capitalisation in relation to NOI



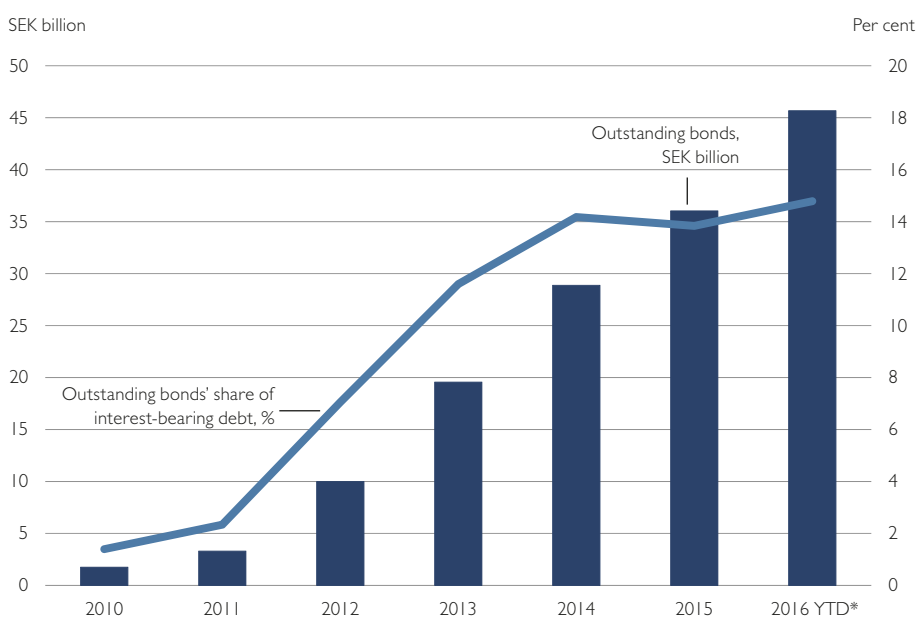
Note. Property companies on Nasdaq OMX Nordic Main Market.

## CREDI – Bonds

Following a noticeably strong second quarter for corporate bonds among listed property companies, the third quarter of 2016 has been surprisingly slow.

In the second quarter of 2016, listed property companies issued a record SEK 6.1 billion in corporate bonds, which was nearly as much as in the entire year of 2015. This increase was a result of the fact that the majority of the listed property companies issued new bonds during the quarter. In the third quarter, however, we see the smallest increase in the volume of outstanding bonds in more than a year, merely SEK 480 million. The reason for this small increase is that only five of the listed companies issued new corporate bonds, while Kungsliden redeemed a large share of its bonds. Nevertheless, corporate bonds still make up 14.8 per cent of the listed property companies' interest-bearing debt, compared to 13.8 per cent in 2015.

Outstanding bonds



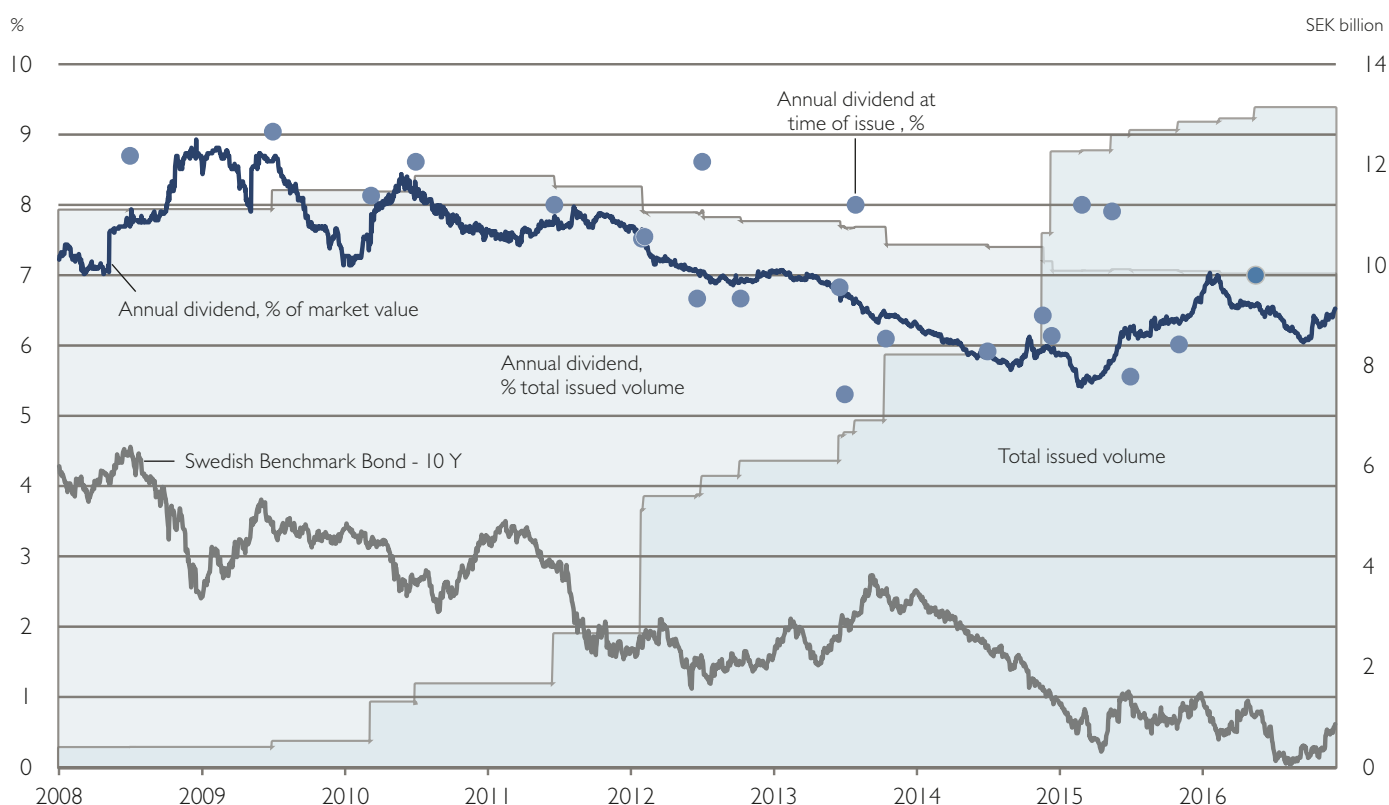
\* Between 01/01/2016 and 30/09/2016

Note. Property companies on Nasdaq OMX Nordic Main Market.

# CREDI – Preference shares

Over the past three months, the average dividend to market prices of property-related preference shares on Nasdaq OMX Nordic Main Market has increased by approximately 50 basis points, mirroring an equally rapid increase in the 10-year Swedish Benchmark Bond.

Property companies' preference shares on Nasdaq OMX Nordic Main Market



Property-related preference shares have had a rather interesting development in 2016. Having fallen throughout the majority of the year, from 7 per cent in February 2016 to nearly 6 per cent in September 2016, the average dividend to market prices (yield) of property-related preference shares on Nasdaq OMX Nordic Main Market has once again increased. As of 5 December 2016 the average yield is 6.52 per cent, which means that the average yield has increased by nearly 50 basis points in less than three months.

This year's volatile changes were preceded by an equally pronounced development where the average yield of property-related preference shares increased from 5.4 per cent in February 2015 to 7 per cent in

February 2016. This marked a clear reversal of the trend that had preceded it. Before February 2015, the average yield had fallen nearly every month since July 2010. The increase was in line with a general increase in risk premiums on debt instruments during this period.

The fluctuations of the average yield are linked to risk premiums and long-term interest rates. The average yield has tracked the 10-year Swedish Benchmark Bond fairly well. Over the past three months in particular, the increase in the average yield is more or less mirrored by the increase in the 10-year Swedish Benchmark Bond.

Over the past 12 months there has only been one issue of property-related preference shares on Nasdaq OMX Nordic Main

Market, namely the issue of Oscar Properties' class B preference share. In addition, there have only been a couple of small issues of preference shares by property companies on Nasdaq First North and Nordic Growth Market.

# CREDI – Catella’s view through the looking glass

A changing macro environment indicates higher average property yields in 2017.

The debt financing market remains in contraction, despite a relatively high risk tolerance among investors. This is most likely a sign of banks’ risk averseness and unwillingness to increase their property exposure. The Swedish equity market has been a leading indicator of the CREDI Current Situation index over time. The equity markets had a strong development during the second half of 2016, which points towards a slight improvement towards the 50.0 turning point of the index during the first half of 2017.

The property transaction volume reached record levels in November as the rolling 12-month transaction volume

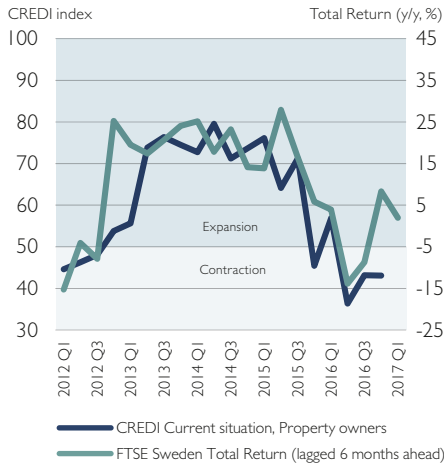
increased to SEK 170 billion. However, the average yield increased in parallel with transaction volumes, which is very unusual. This development is most noticeable for retail properties, and is likely due to more motivated sellers in secondary locations. This move might be driven by changing macroeconomic fundamentals, as long-term interest rates bottomed out during the summer. It has become increasingly clear that the monetary policy of recent years is no longer effective. In addition, the US government will most likely have to increase their borrowing, which will raise long-term interest rates. With regard to Sweden, this means that we will go from a 10-year period of strong, domestically driven GDP growth combined with an imported low inflation and low long-term interest rates to a macro environment with weaker GDP growth,

somewhat higher inflation and slightly higher long-term interest rates.

As economic growth decreases, rental growth falls and vacancy risk increases. At the same time, investors’ access to credit has been reduced lately, which leads to higher property yields and a wider yield gap between properties in A, B and C locations.

Nevertheless, the Swedish property market remains a highly interesting investment option, as there is still a fair amount of growth potential in Sweden. In addition, the country has a liquid and transparent property market. There are many indications that the cyclic weakening trend that is expected to take place in 2017 will be relatively short and mild. Accordingly, far-sighted investors will regard higher property yields and yield gaps between A, B and C locations as a signal to buy.

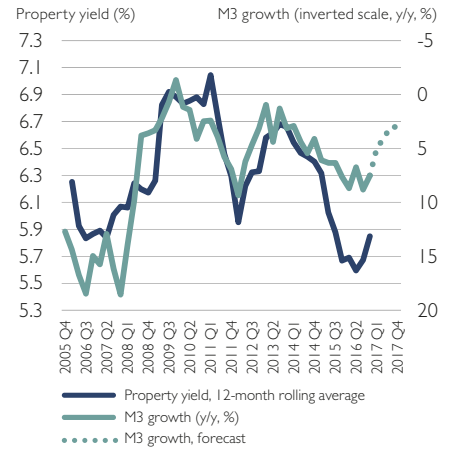
CREDI Current Situation for property owners and FTSE Sweden



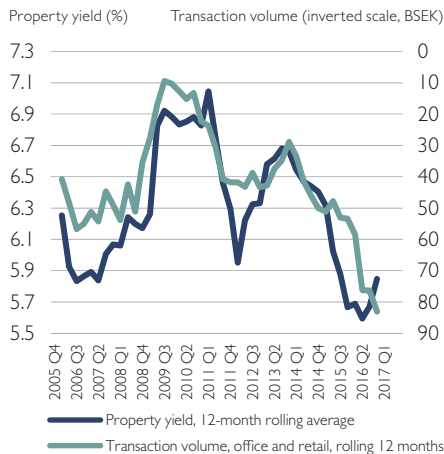
CREDI Current Situation for property owners and M3 growth



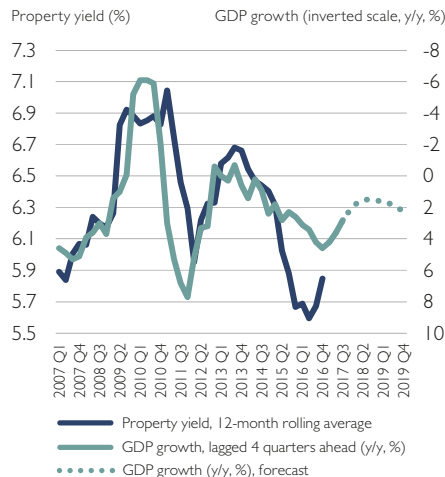
Average property yield\* and M3 growth



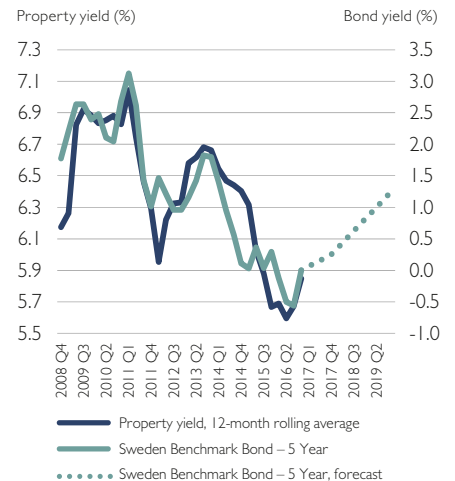
Average property yield\* and transaction volume



Average property yield\* and GDP growth



Average property yield\* and Benchmark Bond



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

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