



CREDI September 2017

# Credit market appears to be back on solid ground

In the September issue of CREDI, the Main index has increased from 41.8 to 49.8, which is the highest index value since September 2015. Property companies in particular believe that the credit market has improved over the past quarter, mainly due to improved credit margins and credit duration.

## THE CREDI MAIN INDEX HAS IMPROVED SIGNIFICANTLY

The property debt financing market is no longer in contraction, as the Main index has increased from 41.8 to 49.8. This is the highest index value since the autumn of 2015, and marks the largest improvement since the summer of 2013.

## PROPERTY COMPANIES VIEW CREDIT MARKET POSITIVELY

In the September survey, property companies had a Current Situation index of 60.2, meaning a majority of the respondents believe that the credit market has improved over the past three months.

## IMPROVED CREDIT AVAILABILITY AND CREDIT DURATION

The Credit Availability and Duration sub-indices have had a positive impact on the Main index. In addition, nearly half of the surveyed property companies believe that credit margins have decreased.

## PROPERTY SHARES ARE ONCE AGAIN TRADING AT A PREMIUM

During the first quarter of 2017, property shares traded at a discount for the first time since 2013. In the second quarter, however, the stock market has recovered and property shares are once again trading at a premium.

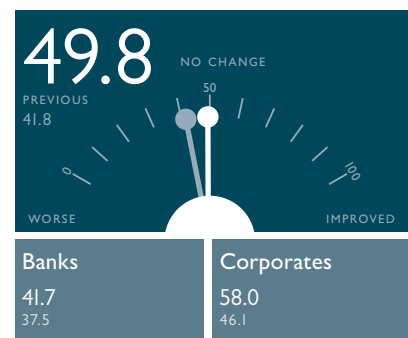
## CORPORATE BONDS STILL POPULAR AMONG PROPERTY COMPANIES...

Following the strongest quarter in history for corporate bonds among listed property companies, the second quarter of 2017 saw a moderate increase in the volume of corporate bonds and their share of interest-bearing debt.

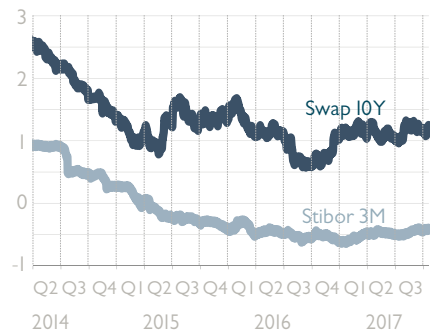
## ...BUT PREFERENCE SHARES ARE BEING REDEEMED

Property companies are looking to redeem their outstanding preference shares. Sagax recently redeemed more than 70 per cent of their shares, causing the total volume on Nasdaq OMX Nordic Main Market to decrease by 8.2 per cent.

## CREDI Main index



Swedish key interest rates, 2014–2017. Per cent



Loan-to-value Q2 average	↓ 52.3%	Interest rate Q2 average	↓ 2.4%	Fixed credit term Q2 average	↓ 3.1 y	Fixed interest term Q2 average	↑ 2.9 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 41.8 to 49.8 in the September survey of CREDI, which is the highest index value since September 2015. The increase is driven by highly positive responses among the surveyed property companies.

## Main index components

In the September issue of CREDI, a significantly improved market sentiment among property companies has had a noticeable effect on the CREDI Main index. Having displayed a sharp turn downwards in June, the Main index has recovered and nearly crosses the 50.0 turning point. The Main index is now at its highest point since September 2015, following the largest quarterly improvement since the summer of 2013.

This new development is driven by a greatly reinvigorated Current Situation index. While the Expectation index improved slightly from 44.8 to 48.7, the Current Situation index rocketed from 38.8 to 50.9. The fact that the Current Situation index is above the 50.0 turning point means

that the property sector as a whole believes that the credit market has improved over the past three months.

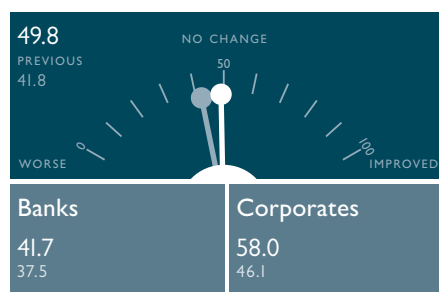
As has been the case throughout the history of CREDI, property companies have exhibited a more positive view of the credit market than the banks. Although property companies and banks reached something of a consensus in 2016, their responses have since diverged, differing more than 16 index points in the September survey. The reason for this could be that banks cater to a wider range of clients. For example, banks might have become more restrictive with their lending towards their average corporate clients, while remaining positive towards large property companies listed on Nasdaq OMX Nordic Main Market.

## Sub-indices

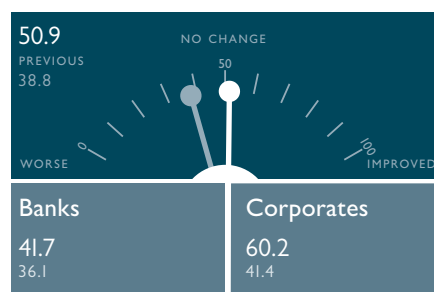
As is common with the CREDI Survey, some of the sub-indices remain unchanged while others have a strong impact on the Main index. Looking at the results from the September survey, we see that the Credit Margins sub-indices have improved considerably. Most noticeably, the Current Credit Margin sub-index increased from 18.4 to 48.0. As such, the sub-index that had the greatest impact on the low Main index in the June survey is nearly at the 50.0 turning point.

The sub-indices Current Credit Availability (54.0), Current Duration (56.8) and Expected Duration (56.8) had a positive impact on the CREDI Main index, while Expected Credit Margins (41.7) and Current Leverage (44.9) had a negative impact.

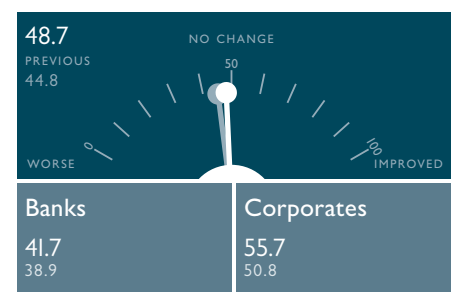
## CREDI Main index



## 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

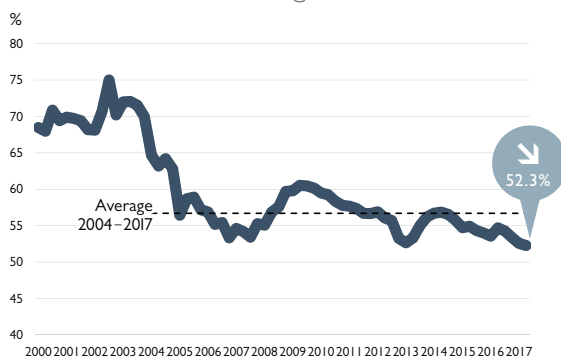
sentiment is 50 and any reading below this level indicates more difficult financing conditions while any reading above indicates less difficult financing conditions.

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

In the second quarter of 2017, the average loan-to-value and average interest rate continued to fall, while a continuation of the increasing fixed interest term could suggest that the listed property companies are becoming more careful with regard to their debt financing.

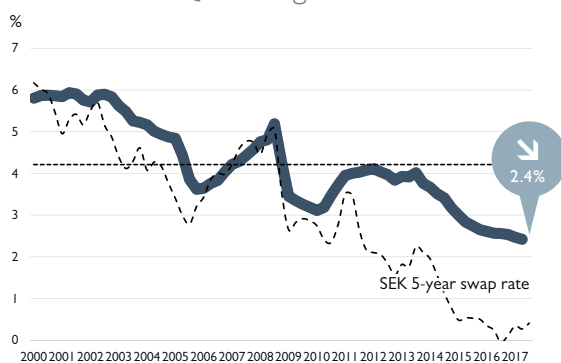
Listed sector Q2 average loan-to-value<sup>1</sup>



The listed property companies' loan-to-value decreased slightly in the second quarter of 2017, from 52.6 per cent to 52.3 per cent. As such, the average loan-to-value of the listed sector is noticeably below the historical average of 56.7 per cent. With regard to the underlying components, property values increased by 3 per cent, from SEK 641 billion to SEK 661 billion, and interest-bearing debt increased by 3 per cent, from SEK 327 billion to SEK 336 billion. As such, the decrease in loan-to-value is driven by increased property value rather than decreased debt.

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

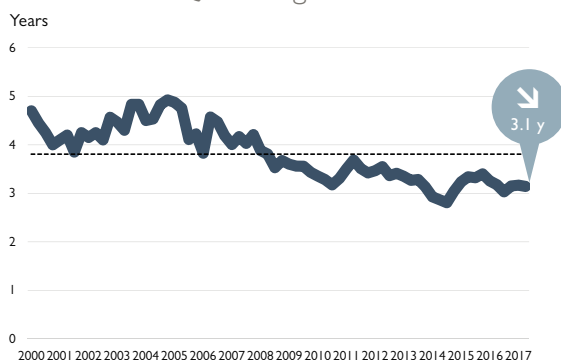
Listed sector Q2 average interest rate<sup>2</sup>



In the second quarter of 2017, the average interest rate decreased from 2.47 per cent to 2.42 per cent. This is a continuation of the trend of decreasing interest rates that stretches back to the third quarter of 2013. Nearly half of the listed property companies reported a reduced interest rate during the quarter, while only 10 per cent of the companies saw their interest rate increase.

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

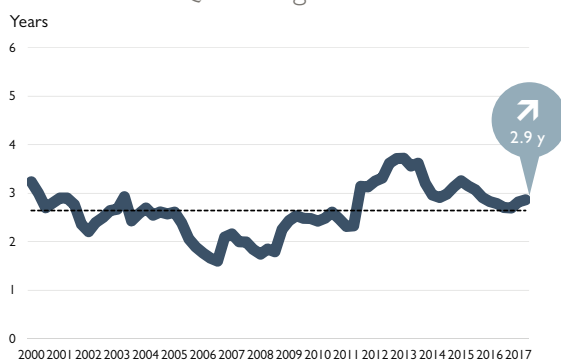
Listed sector Q2 average fixed credit term<sup>3</sup>



The average fixed credit term among listed property companies decreased from 3.2 years to 3.1 years in the second quarter of 2017. Approximately one third of the surveyed companies extended their fixed credit term during the quarter, while nearly two thirds of the surveyed companies reduced their fixed credit term.

3 Average maturity referring to interest-bearing debt.

Listed sector Q2 average fixed interest term<sup>4</sup>



Following seven consecutive quarters of falling fixed interest terms, the average fixed interest term among listed property companies increased from 2.7 to 2.8 years in the first quarter of 2017. This increase continued in the second quarter, as the average fixed interest term increased from 2.8 to 2.9 years. The increase suggests that property companies do not expect interest rates to decrease further in the near future. Consequently, the average fixed interest term moves further away from the long term average of 2.6 years.

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.

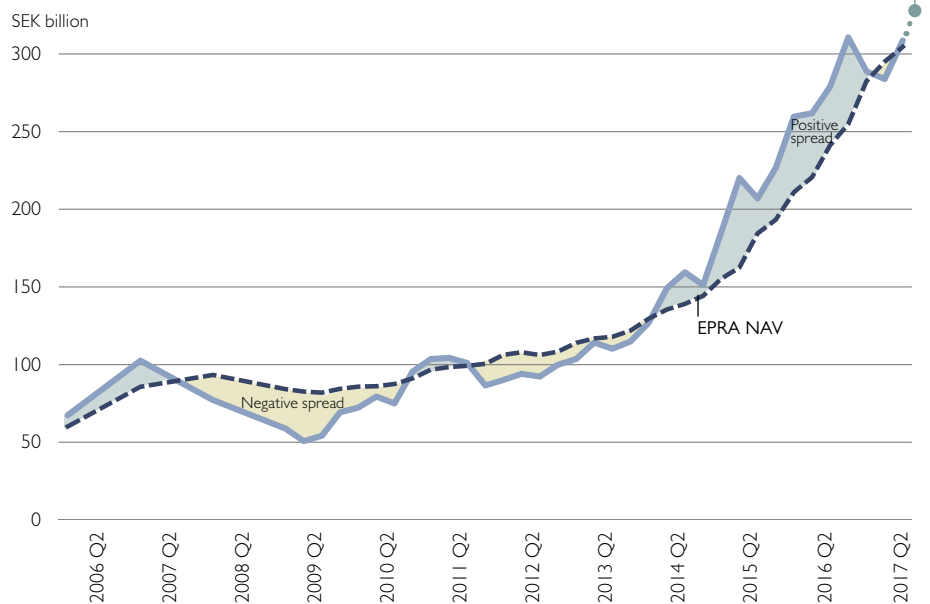
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

# CREDI – Common shares

Following two consecutive quarters of a falling stock market, listed property companies saw their market capitalisation improve considerably in the second quarter of 2017. As a result, property shares are once again trading at a premium.

The market capitalisation of property companies on Nasdaq OMX Nordic Main Market increased in the second quarter of 2017, reaching SEK 309 billion. At the same time, the listed property companies' EPRA NAV increased from SEK 295 billion to SEK 305 billion, which is an all-time high. Consequently, the listed property companies went from being traded at a discount at the end of the previous quarter, to being traded at a slight premium of 1.3 per cent. Furthermore, since the end of the second quarter, the stock market has improved considerably and the listed companies' market capitalisation has increased an additional 3.6 per cent as of 18 September 2017. This means that we might see a higher market premium at the end of the third quarter of 2017.

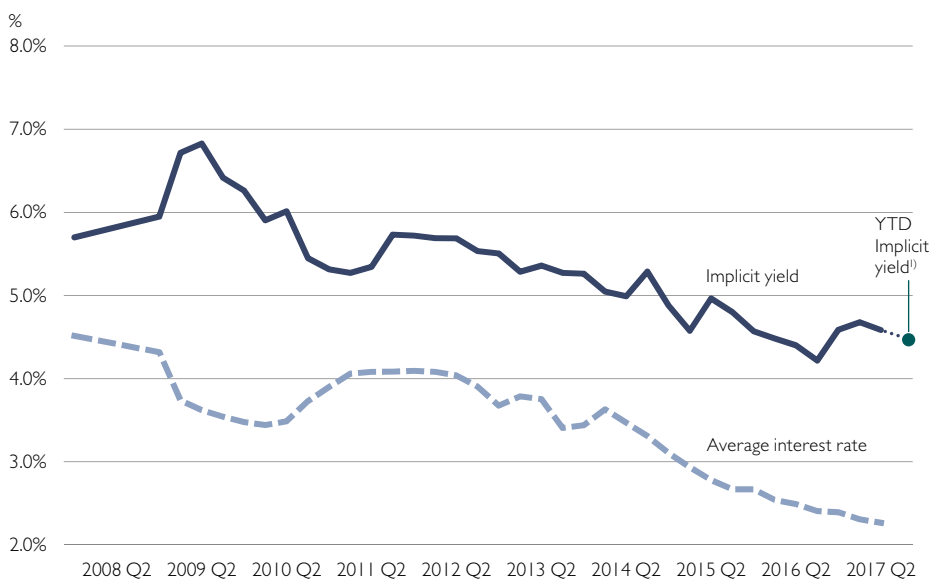
Premium or discount – market capitalisation and EPRA NAV



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 property companies on Nasdaq OMX Nordic Main Market decreased slightly from 4.7 per cent in the first quarter of 2017 to 4.6 per cent in the second quarter of 2017. The higher implicit yield is the result of the stock market valuing the property companies' net operating income higher than in the previous quarter, as the market capitalisation of the listed sector increased at a higher rate than the sector's net operating income. Furthermore, the year-to-date implicit yield indicates a lower average implicit yield for the third quarter of 2017, as a result of the stock market having improved further as of 18 September 2017.

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

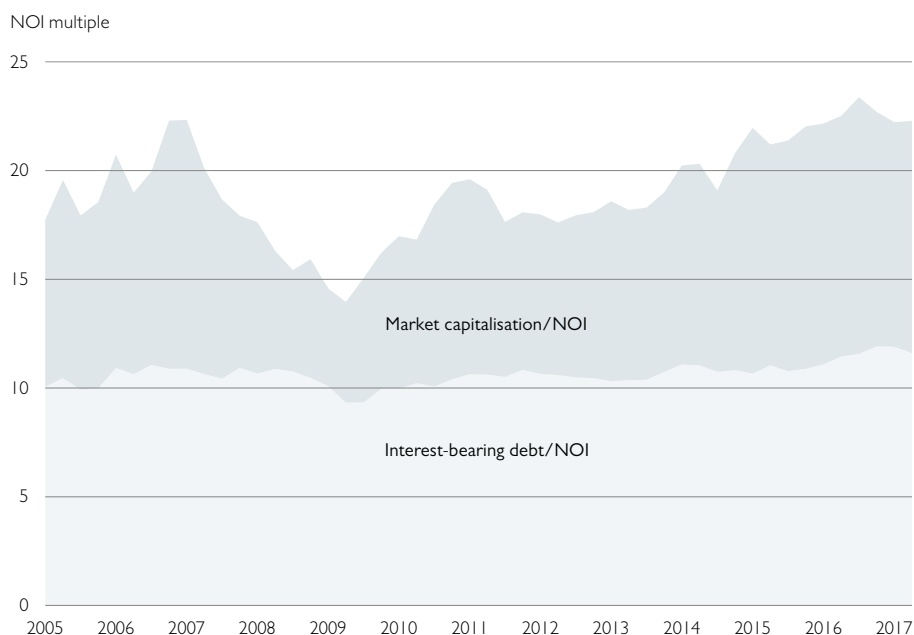


¹) Market values 18/09/2017 and 2017 Q2 EPRA NAV.

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 2007, the stock market valued the listed property sector at 11.4 times its net operating income, while interest-bearing debt was approximately 10.9 times net operating income. In reaction to the financial crisis, however, market capitalisation would fall to 4.5 times net operating income, while debt never fell below a multiple of 9.3. This means that banks have increased their lending in tandem with property companies' cash flow development, which has resulted in a lower loan-to-value as property value has increased faster than net operating income. In the second quarter of 2017, interest-bearing debt decreased slightly from 11.9 to 11.6 times net operating income, while market capitalisation increased from 10.3 to 10.7 times net operating income.

### Interest-bearing debt and market capitalisation in relation to NOI



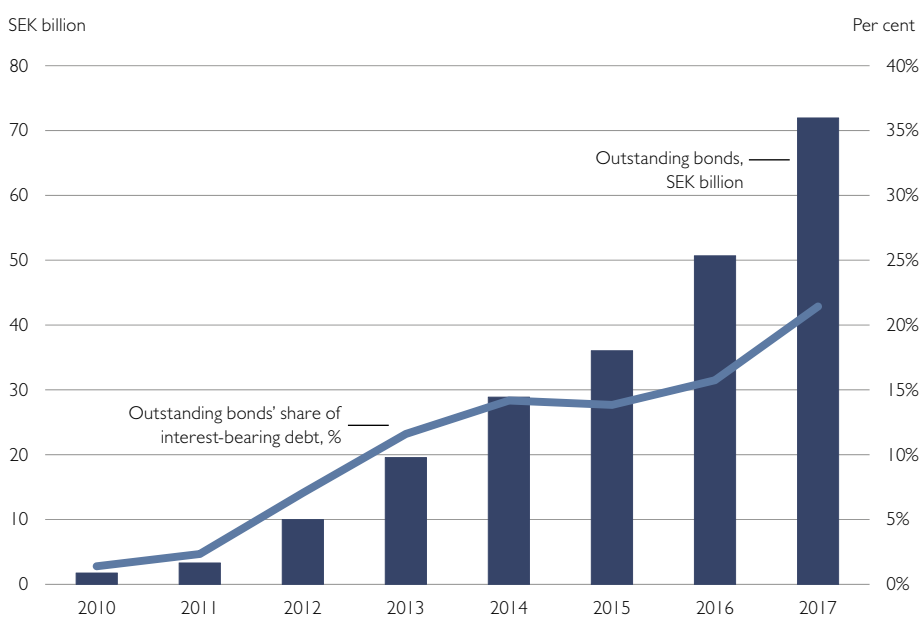
Note. Property companies on Nasdaq OMX Nordic Main Market.

## CREDI – Bonds

Following the strongest quarter in history, the second quarter of 2017 saw a moderate increase in the volume of corporate bonds as well as their share of interest-bearing debt among listed property companies.

Bonds have become increasingly more popular among property companies on Nasdaq OMX Nordic Main Market. Having amounted to less than SEK 2 billion at the end of 2010, the total volume of outstanding corporate bonds reached SEK 72 billion at the end of the second quarter of 2017. Since the turn of the year, the outstanding volume has increased by more than SEK 21 billion, or 42 per cent, making it the largest proportional biannual increase since 2013 and the largest ever nominal biannual increase. This increase was to a great extent a result of Balder issuing EUR 1 billion in the European bond market during the first quarter of 2017. During the second quarter, Fabega and Hemfosa increased their volume of outstanding bonds noticeably. At the end of the second quarter, corporate bonds made up 21.4 per cent of listed property companies' interest-bearing debt.

### Outstanding bonds



Note. Property companies on Nasdaq OMX Nordic Main Market.

# CREDI – Preference shares

Throughout 2017, the average dividend of property-related preference shares on Nasdaq OMX Nordic Main Market has fallen, despite a recovering 10-year SEK Bond. Nevertheless, there has not been a single issue in more than a year and property companies have started to redeem their outstanding preference shares.

Property companies' preference shares on Nasdaq OMX Nordic Main Market



It has been an uneventful year for preference shares, with not been a single new issue in the past sixteen months on Nasdaq OMX Nordic Main Market. Until recently, the total issued volume remained at SEK 13.1 billion, for which property companies pay an average dividend of 7.0 per cent on the issued volume.

However, while the average dividend paid by property companies has remained constant since the most recent issue, the secondary market has seen fairly large fluctuations. Since the most recent issue in May 2016, the average dividend has dropped to 6.0 per cent in mid-September 2016, bounced back to 6.7 per cent at the end of the year, peaked at 6.9 per cent at the end of January 2017, and has since fallen

considerably. As of 18 September, the average dividend is 6.1 per cent.

The fluctuations of the average yields are strongly linked to long-term interest rates. For the past sixteen months in particular, the fluctuations of the average dividend on the secondary market are more or less mirrored by the development of the 10-year SEK Bond, which is currently hovering around 0.6 per cent.

In previous issues of CREDI, the rise of the bond market as an attractive source of capital has been discussed, as has its potential impact on new issues of preference shares. In particular, property companies have become increasingly averse towards preference shares due to their impact on credit ratings, often being categorised as

equal parts equity and debt. Over the past couple of months, property companies' aversion towards preference shares has become even clearer.

On 30 June 2017, Sagax redeemed more than 70 per cent of their outstanding preference shares. As a result, the total issued volume of preference shares dropped from SEK 13.1 billion to SEK 12 billion, an 8.2 per cent decrease. Furthermore, Balder has announced plans to redeem all of their 10 million outstanding preference shares. If this were to happen, the total issued volume would drop further from SEK 12 billion to SEK 9.2 billion, which would constitute a 24 per cent decrease.

# CREDI – Catella’s view through the looking glass

The Current Situation index indicates improving sentiments for property companies, and opportunities are also arising outside the major cities.

The market sentiment among property companies improved significantly in the September survey of CREDI. The Swedish equity market has been a strong leading indicator of the CREDI Current Situation index for property owners over time.

The past 12 months’ strong development on the equity market is well in line with the improvements of the Current Situation index for property owners. The equity market indicates index levels slightly above the 50.0-mark in the coming quarters (which indicates a neutral market sentiment).

The CREDI Current Situation index for property owners is a good leading indicator

of Swedish banks’ lending to property companies, which in turn is a very strong leading indicator of the transaction volume for office and retail properties (the correlation coefficient for quarterly data over ten years is 0.78, where bank lending is two quarters ahead of the transaction volume).

Taken as a whole, the majority of large property investors – both private and institutional – are currently focusing on the same office and retail locations in the large cities, while there are many sellers but few investors in locations with lower priority.

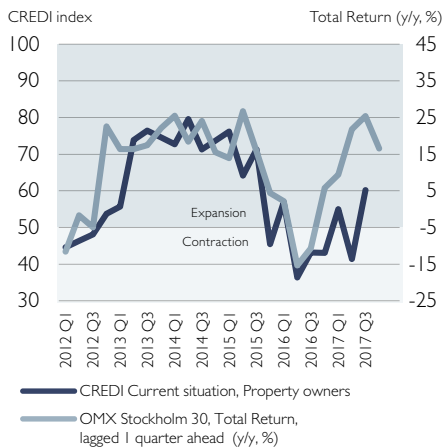
The average yield for commercial properties has remained stable during 2017, and has even fallen back somewhat in recent quarters (the average yield has, however, increased from the historic lows achieved in mid-2016). The negative real interest rates and strong GDP growth is a powerful

combination that benefits property as an asset class.

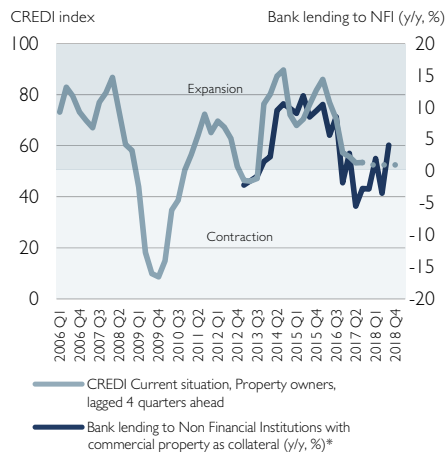
Investor demand for prime office and retail properties in the major cities is expected to remain strong, although yield spreads between A, B and C locations in the major cities will likely increase in the coming years. However, there are good opportunities for investors with good market-knowledge, access to financing and efficient management models to invest in locations outside the major cities without encountering a lot of competition.

The recent CREDI development indicates a stabilisation in the banks’ lending as well as in transaction volumes in the coming 9–12 months, along with an additional 30–50 basis point increase in the average yield for office and retail properties.

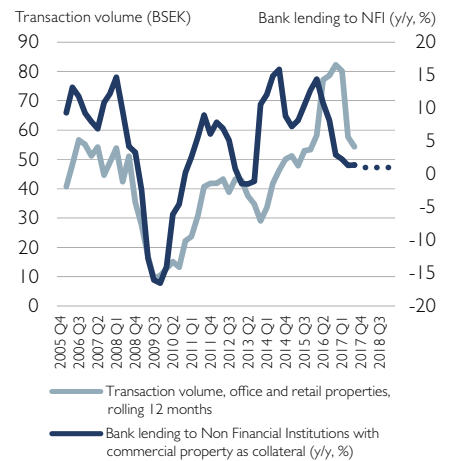
CREDI Current Situation index for property owners and OMX Stockholm 30



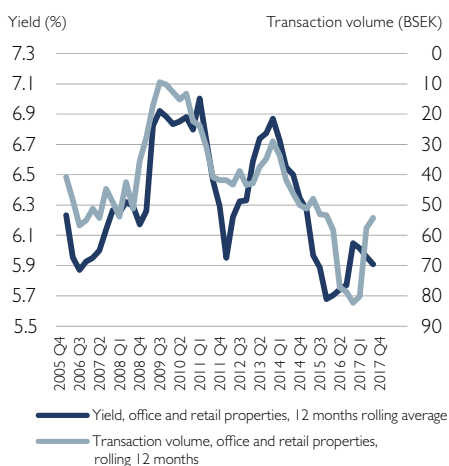
CREDI Current Situation and bank lending with commercial property as collateral



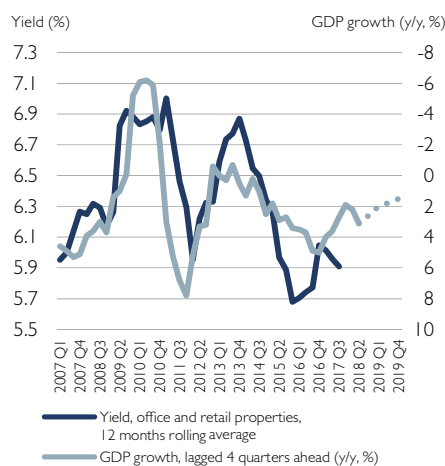
Transaction volume and bank lending with commercial property as collateral



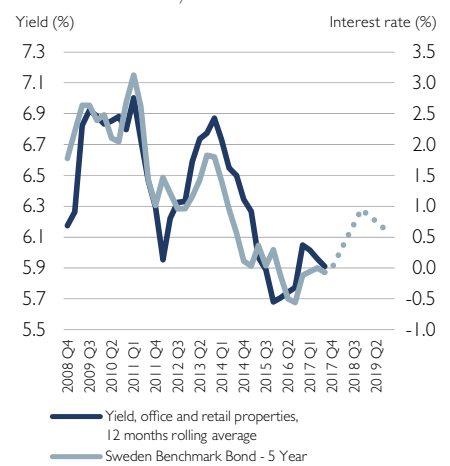
Average property yields\* and transaction volume



Average property yields\* and GDP growth



Average property yields\* and Swedish Benchmark Bond yields



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

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