CREDI December 2017

Stabilized credit market, but uncertain times ahead

In the December issue of CREDI, the Main index increased from 49.8 to 50.3, marking the first time the credit market has improved since September 2015. Property companies are particularly optimistic, while banks remain more cautious. Furthermore, the trend of replacing preference shares with other financial instruments continues.

THE CREDI MAIN INDEX ABOVE THE 50.0 TURNING POINT

For the first time in over two years, the CREDI Main index has crossed the 50.0 turning point, indicating an improved credit market.

PROPERTY COMPANIES HAVE POSITIVE VIEW OF CREDIT MARKET

In the December survey, property companies had a Current Situation index of 62.5, meaning a majority of the respondents believe that the credit market has improved significantly over the past three months.

LOWERED EXPECTATIONS FOR CREDIT MARKET IN THE FUTURE

Although the CREDI Main index has improved, the Expectation index fell from 48.7 to 46.7 in the December survey. The banks are noticeably more pessimistic of the future development, while property companies believe that the credit market will improve in the coming three months.

PROPERTY SHARES STILL TRADING AT A PREMIUM

Property shares traded at a premium for the second consecutive quarter, following a short-lived market discount during the first quarter of 2017.

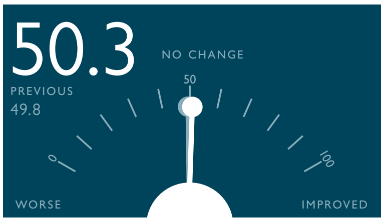
ONE THIRD OF PREFERENCE SHARES REDEEMED IN 2017...

Balder has redeemed all of their 10 million outstanding preference shares, amounting to nearly SEK 3 billion. In total, around one third of all property-related preference shares on Nasdaq Stockholm Main Market has been redeemed this year.

...AND CORPORATE BONDS AT RECORD HIGH

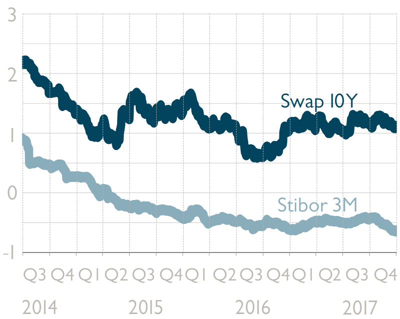
During the third quarter, Balder carried out its second issue of bonds in Euro, amounting to EUR 850 million. At the end of the quarter, property companies on Nasdaq Stockholm Main Market had outstanding bonds amounting to SEK 82.7 billion, which is nearly 24 per cent of their interest-bearing debt.

CREDI Main index



Banks	Corporates
43.0	57.6
41.7	58.0

Swedish key interest rates, 2014–2017. Per cent



Loan-to-value Q3 average → 52.3%	Interest rate Q3 average ↘ 2.3%	Fixed credit term Q3 average ↗ 3.2 y	Fixed interest term Q3 average ↘ 2.7 y

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.com/CREDI

The CREDI Survey

The CREDI Main index increased from 49.8 to 50.3 in the December survey of CREDI, which is the first time the Main index has passed the 50.0 turning point since September 2015. Property companies have a positive view of the credit market, while banks remain negative.

Main index components

In the December issue of CREDI, a continued positive market sentiment among property companies, coupled with a slightly less negative view of the credit market among banks, has pushed the CREDI Main index past the 50.0 turning point for the first time since September 2015. The survey was conducted in December, taking place after the news and subsequent market reaction regarding stalled or cancelled residential projects.

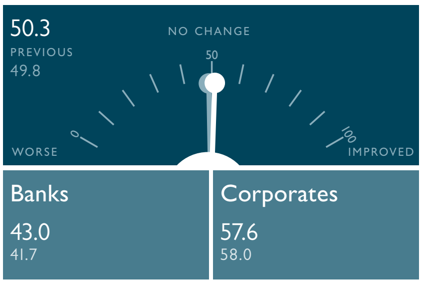
In the December survey, property companies and banks have a more positive view of the current situation of the credit market, while their view of the future development is slightly worse and noticeably the banks predict an accelerated negative development over the next three months. The Current Situation index has increased from 50.9 to 53.9, while the Expectation index has fallen slightly from 48.7 to 46.7. This means that the market as a whole believes that the credit market has improved over the past three months, and that it will worsen over the coming three months.

Although property companies and banks reached a consensus in 2016, their responses have since diverged. In the December survey, their responses differed nearly 15 index points. The reason for this could be that banks cater to a wider range of clients, while listed property companies are a group of generally strong borrowers that have also been successfully tapping into the attractive bond market.

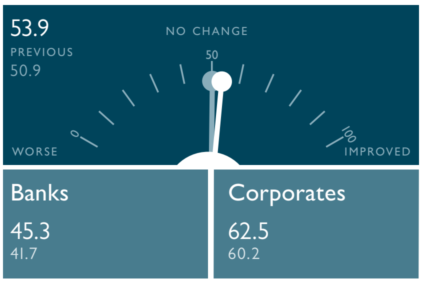
Sub-indices

Looking at the results from the December survey, we see that the sub-indices Credit Availability, Credit Margins and Duration have had a positive impact on the Current Situation index, while the Leverage sub-index is noticeably poor. On the other hand, with regard to the Expectation index, all sub-indices have poor results except for the Duration sub-index, which stands out as the only sub-index with strong results both for the current situation and for the expected development in the future.

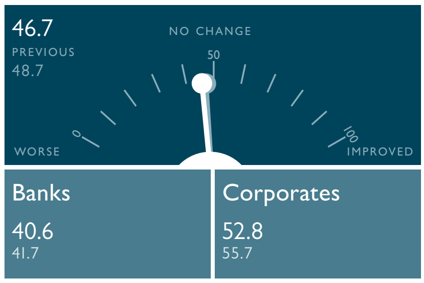
CREDI Main index



Current Situation



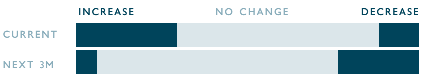
Expectation



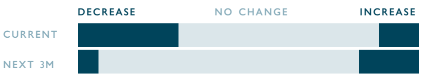
CREDI sub-indices

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.

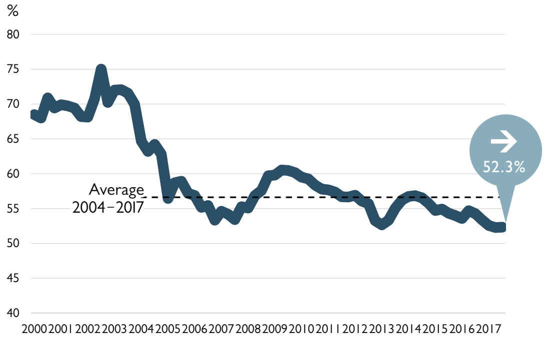
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 third quarter of 2017, listed property companies' average interest rate continued to fall, while the average loan-to-value shows signs of having bottomed out.

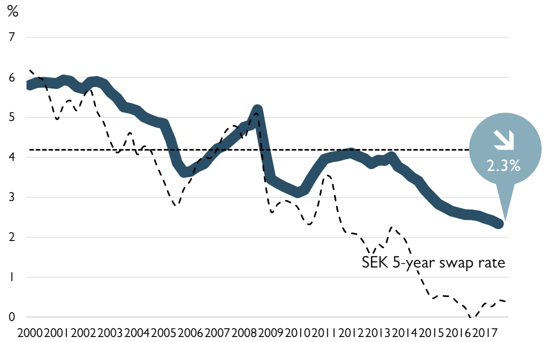
Listed sector Q3 average loan-to-value[1]



The listed property companies' loan-to-value remained unchanged at 52.3 per cent during the third quarter of 2017, noticeably below the historical average of 56.7 per cent, and appears to have bottomed out. With regard to the underlying components, property values increased from SEK 661 billion to SEK 682 billion, while interest-bearing debt increased from SEK 336 billion to SEK 348 billion. As such, property value and interest-bearing debt appear to have increased in tandem during the quarter.

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

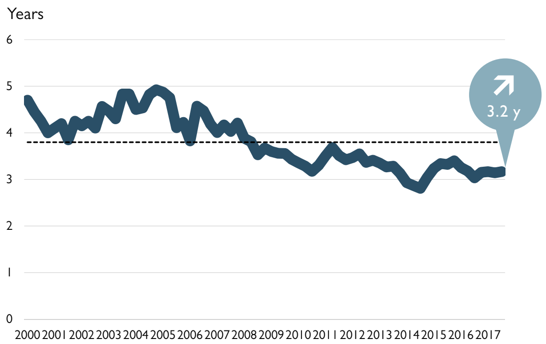
Listed sector Q3 average interest rate[2]



In the third quarter of 2017, the average interest rate decreased from 2.42 per cent to 2.34 per cent. This is a continuation of the trend of decreasing interest rates that stretches back to the third quarter of 2013. The majority of property companies reported a reduced interest rate during the quarter, while not a single company saw its interest rates increase.

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

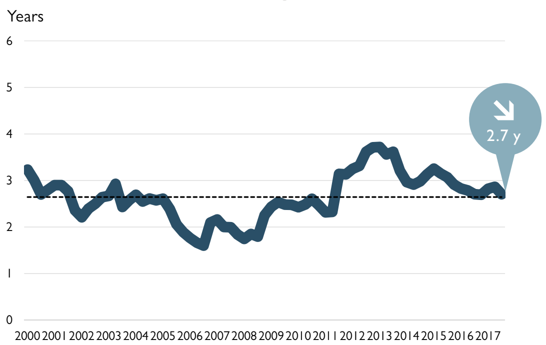
Listed sector Q3 average fixed credit term[3]



The average fixed credit term among listed property companies increased from 3.1 years to 3.2 years in the third quarter of 2017. Approximately one third of the surveyed companies extended their fixed credit term during the quarter, while slightly more than half of the surveyed companies reduced their fixed credit term.

3 Average maturity referring to interest-bearing debt.

Listed sector Q3 average fixed interest term[4]



-------- Average 2000–2017

Following two quarters of increasing fixed interest terms, the average fixed interest term among listed property companies fell from 2.9 to 2.7 years in the third quarter of 2017. As such, the average fixed interest term has fallen to the same level as during the third and fourth quarter of 2016. This decrease means that the average fixed interest term moves closer towards 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 QI 2000.

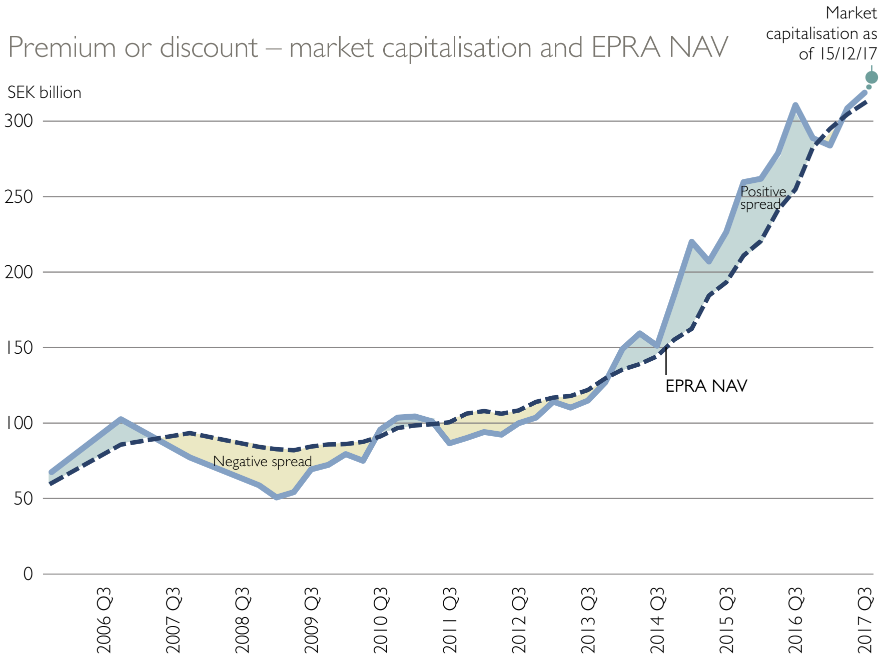
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

During the third quarter of 2017, listed property companies have seen their market capitalisation improve slightly, mirroring the increase in net operating income. In addition, property shares are trading at a premium for the second consecutive quarter.

Shares in property companies on Nasdaq Stockholm Main Market traded at a slight premium at the end of the third quarter of 2017. Market capitalisation increased from SEK 309 billion to SEK 319 billion, which is approximately two per cent higher than the property companies' EPRA NAV of SEK 312 billion. This marks the second consecutive quarter of listed property companies being traded at a premium, having traded at a discount at the end of the first quarter of 2017. Furthermore, since the end of the third quarter, the stock market has improved slightly and the listed companies' market capitalisation has increased to approximately SEK 326 billion as of 15 December 2017. Accordingly, we might see a third consecutive quarter of market premiums.

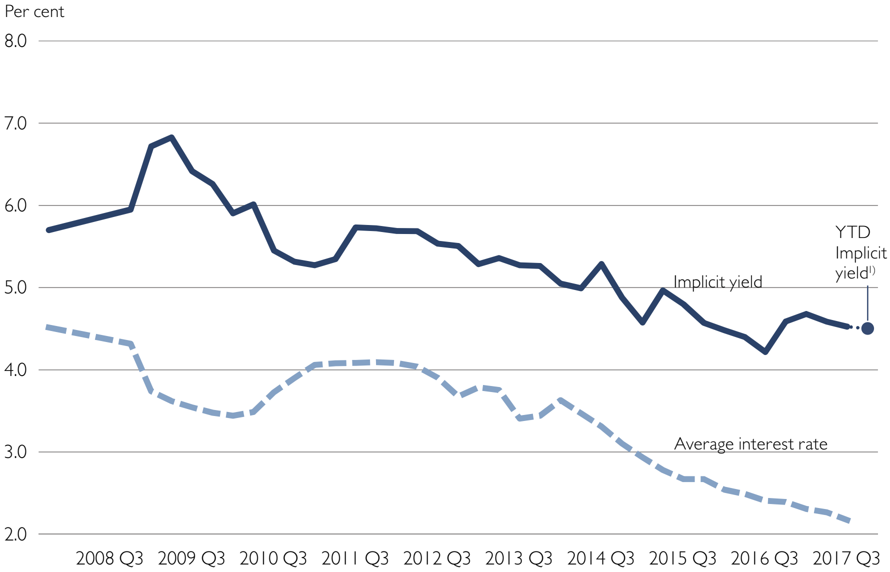
Premium or discount – market capitalisation and EPRA NAV



Note. Property companies on Nasdaq Stockholm 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 Stockholm Main Market decreased slightly from 4.6 per cent in the second quarter of 2017 to 4.5 per cent in the third quarter of 2017. The lower 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 stabilized average implicit yield for the fourth quarter of 2017, as a result of the stock market having improved slightly as of 15 December 2017.

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



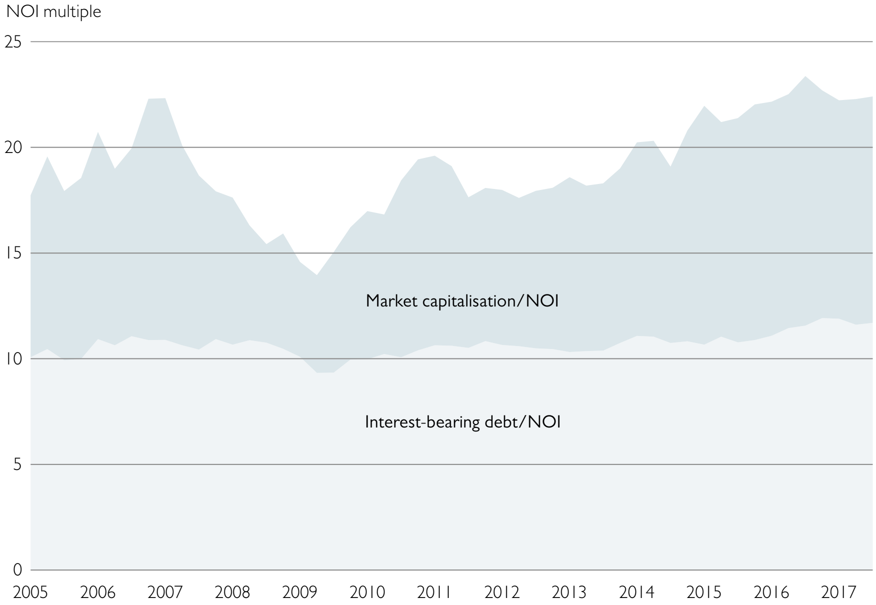
[1] Market values 15/12/2017 and 2017 Q3 EPRA NAV.

Note. Property companies on Nasdaq Stockholm 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.

Source: Catella, annual reports, Nasdaq.

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 decreased to 4.5 times net operating income, while debt never fell below a multiple of 9.3. This means that banks have adjusted 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 third quarter of 2017, interest-bearing debt increased slightly from 11.6 to 11.7 times net operating income, while market capitalisation has stabilized at 10.7 times net operating income.

Interest-bearing debt and market capitalisation in relation to NOI



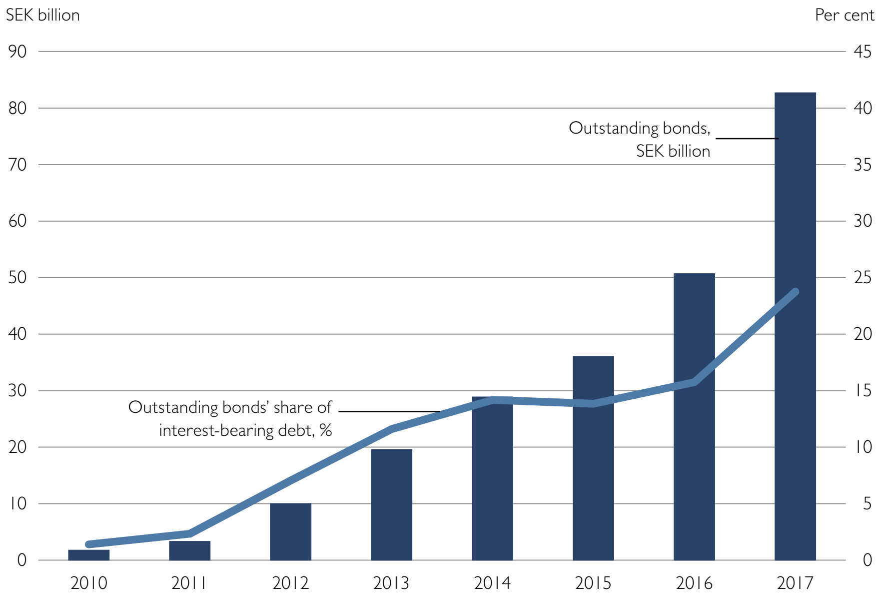
Note. Property companies on Nasdaq Stockholm Main Market.

Bonds

The third quarter of 2017 saw a sustained increase in property companies' volume of outstanding bonds and their share of interest-bearing debt, both of which are at an all-time high.

Corporate bonds continue to be popular among property companies on Nasdaq Stockholm Main Market. During the third quarter of 2017, outstanding bonds have reached SEK 82.7 billion. This entails a 63 per cent increase since the end of 2016 and an 81 per cent increase over the past four quarters, marking the highest proportional increase in volume since the first quarter of 2014. This increase is to a great extent a result of Balder issuing EUR 850 million in the European bond market during the third quarter of 2017, in addition to the EUR 1 billion the company issued during the first quarter. At the end of the third quarter, corporate bonds made up 23.8 per cent of listed property companies' interest-bearing debt.

Outstanding bonds

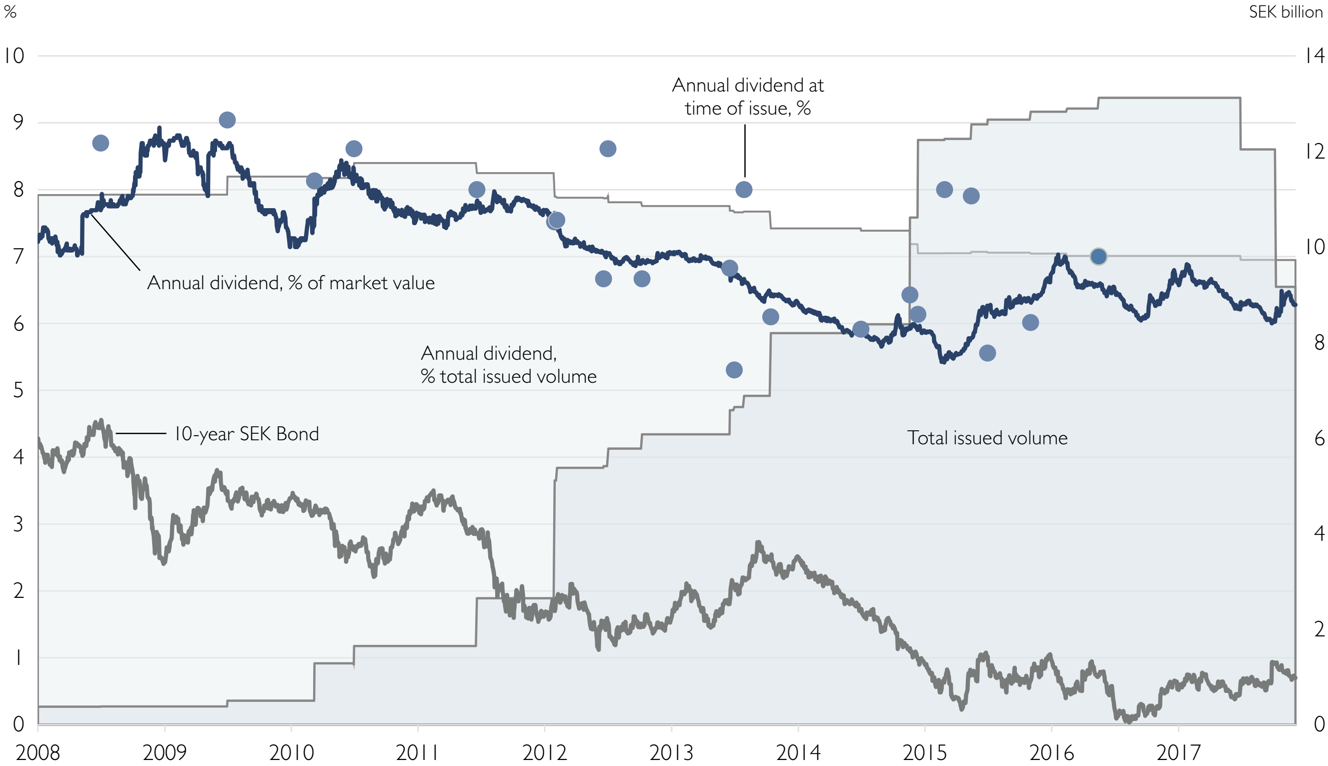


Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The Swedish residential market has become noticeably volatile in the past months, which has affected the secondary market for preference shares. In addition, a major redemption of preference shares by Balder has reduced the outstanding volume by nearly SEK 3 billion.

Property companies' preference shares on Nasdaq Stockholm Main Market



During 2017, the market for property-related preference shares shrunk noticeably. Since the beginning of the year, the outstanding volume of shares has fallen by more than 30 per cent, following significant redemptions by Sagax and Balder.

On 30 June 2017, Sagax redeemed more than 70 per cent of their outstanding preference shares, amounting to nearly SEK 1.1 billion. Furthermore, on 9 October, Balder redeemed 10 million preference shares, amounting to approximately SEK 2.9 billion. As a result, the outstanding volume of property-related preference shares on Nasdaq Stockholm Main Market has fallen from SEK 13.1 billion to SEK 9.2 billion in less than six months. The reason for the redemption of preference shares is to improve the companies' rating and reduce costs. For example, Balder paid 6.95 per cent in dividends on outstanding preference shares, whereas the company's recent hybrid bond has an interest rate of 3.13 per cent before taxes. Thus, Balder saves around SEK 130 million annually by replacing its preference shares with bonds.

Although there has not been a single new issue of preference shares on Nasdaq Stockholm Main Market in the past nineteen months, NP3 recently announced that it is considering issuing SEK 300 million in preference shares in 2018.

The secondary market has seen noticeable changes in the past months. This is to some extent a consequence of the market sentiment with regard to new construction of residences in Sweden. In October, several residential developers announced that they were altering, postponing or cancelling residential projects. This had an impact on the yield for Oscar Properties' preference share A, which increased from 6.9 per cent to 10.6 per cent in approximately two weeks, following a 33 per cent drop in share price. Interestingly, the price for Oscar Properties' preference share B only fell by 12 per cent during the same period, likely due to the investors' right to redeem said preference share at a given price.

The average dividend increased from 6.0 per cent to 6.5 per cent during the month of October. However, the average dividend has since decreased to approximately 6.3 per cent as of 15 December 2017.

Catella's view through the looking glass

There will be a strong demand for properties in good locations in the major cities from well-consolidated investors with good access to credit.

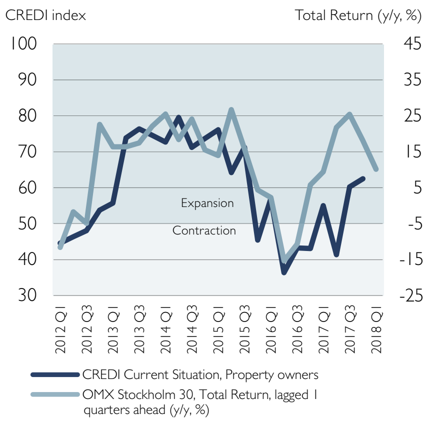
The Swedish equity market has been a strong leading indicator of the CREDI Current Situation index for property owners over time. The equity market indicates that index levels will remain slightly above the 50-mark in the coming quarters. However, the wide gap in access to credit between the large, well-established property companies and smaller investors without a strong track-record will probably increase further.

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 leading indicator of the transaction volume for office and retail properties. The sentiments on the property market have changed lately and transaction processes outside the attractive locations in the major cities are going slower. Over time, there is a strong negative correlation between transaction volume and the average yields for commercial properties (when volumes increase the average yields go down and vice versa). In recent months, however, average yields have fallen in line with the transaction volumes. The most probable explanation for this is that the market is in the midst of a repricing process. Buyers and sellers are generally meeting up in good locations in the major cities, while their view of the pricing differs in other locations. Catella expects the average yields for commercial properties to increase over the coming 6–12 months (mainly by means of increasing yield spreads between A, B and C locations).

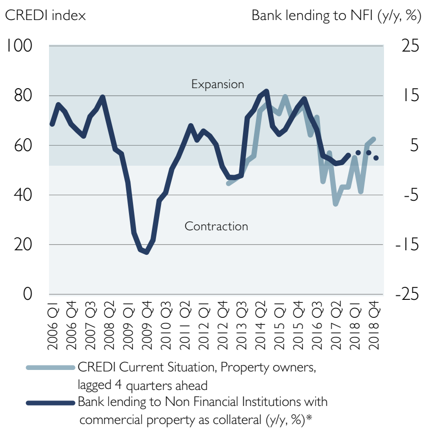
Condominium prices in Stockholm have fallen by nearly 10 per cent over the past three months. Housing prices are a strong leading indicator of GDP growth, and the lower housing prices indicate falling residential investments and lower private consumption growth in 2018. Lower GDP growth (combined with somewhat less expansive monetary policy) is expected to push the market towards a cyclical slowdown in 2018. This will affect the commercial property sectors with lower rental growth, higher vacancies and more risk averse investors and banks.

The underlying fundamentals for Swedish property, however, remain good with continuously low or negative real interest rates, resulting in a strong demand for properties in good locations the major cities from institutions and well-consolidated private investors with access to financing.

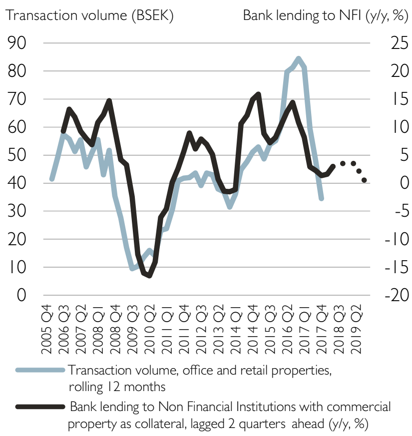
CREDI Current Situation and OMX Sthlm 30



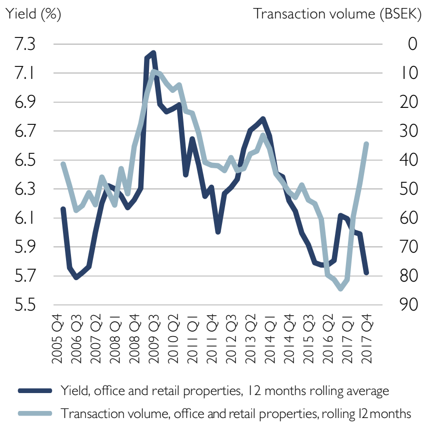
CREDI Current Situation and bank lending



Transaction volume and bank lending

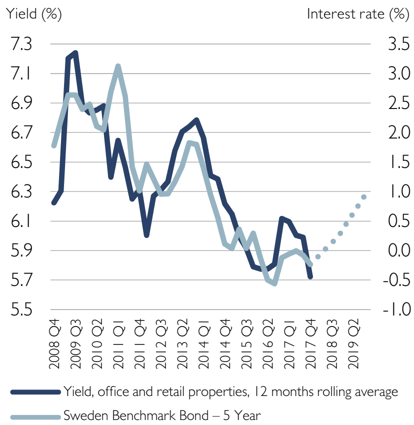


Average property yields* and transaction volume



Average property yields* and GDP growth

Average property yields* and interest rates



Source: FactSet and Catella

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

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Contacts

Martin Malhotra
Partner
Direct: +46 8 463 34 05
SMS: +46 70 311 34 05
martin.malhotra@catella.se

Arvid Lindqvist
Head of Research
Direct: +46 8 463 33 04
SMS: +46 72 537 17 45
arvid.lindqvist@catella.se

Max Doherty
Analyst
Direct: +46 8 463 33 73
SMS: +46 72 207 10 27
max.doherty@catella.se

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CATELLA

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HQ: Birger Jarlsgatan 6, Stockholm
info@catella.se
catella.se/corporatefinance