CREDI December 2018

Tightened access to credit market for property companies

In the December issue of CREDI, the Main index falls from 49.6 to 48.6 as access to the credit market tightens. Property companies maintain a positive view of the credit market as interest rates fall to a record low, but uncertainty looms as credit margins appear to rise in the future.

CREDI SURVEY REFLECTS A SHIFT IN THE CREDIT MARKET

The December survey shows that credit margins have fallen, while access to credit has worsened. Credit is still affordable when available, but the credit market as a whole is tightening.

CONTINUED TREND OF PESSIMISM TOWARDS FUTURE DEVELOPMENT

Since September 2017, surveyed banks and property companies have been fairly positive about the current credit climate while exhibiting pessimism regarding the future development of the credit market, although this negative development has yet to materialise.

AVERAGE INTEREST RATE FALLS TO A NEW RECORD LOW

Yet again, the average interest rate of listed property companies has fallen to a new record low. In the third quarter of 2018, the average interest rate fell to 2.0 per cent, which is the lowest rate observed in the history of CREDI.

STOCK MARKET RECOVERS AS SHARES TRADE AT A PREMIUM

Following three consecutive quarters where property companies' shares have traded at a discount, the stock market has now recovered and shares are trading at a premium.

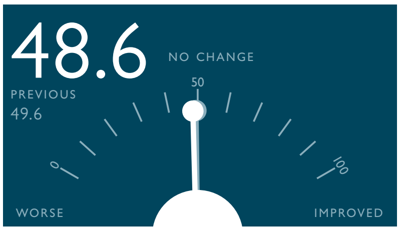
LARGE EURO BOND ISSUE BY SAGAX BOOSTS BOND MARKET

The bond market in 2018 has not been able to maintain the growth observed in the record year of 2017. Nevertheless, the volume of outstanding bonds among property companies increased by 8 per cent in the third quarter, following a EUR 500 million issue by Sagax.

MARKET FOR PREFERENCE SHARES TAKES A SUBSTANTIAL HIT

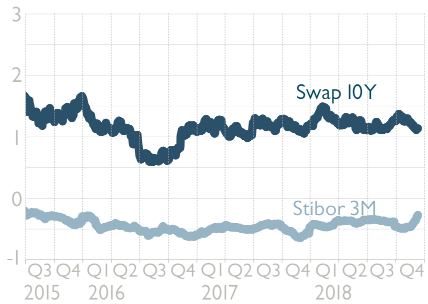
Property-related preference shares have struggled at the end of 2018, as the average dividend on the secondary market increased from 6.0 to 6.5 per cent, while class D common shares are increasingly being viewed as a replacement.

CREDI Main index



Banks	Corporates
47.2	50.0
43.8	55.4

Swedish key interest rates, 2015–2018. Per cent



Loan-to-value Q3 average	Interest rate Q3 average	Fixed credit term Q3 average	Fixed interest term Q3 average
→ 52%	↘ 2.0%	↘ 3.4 y	→ 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.

The CREDI Survey

In the December survey of CREDI, the credit market sees a slight negative development as the CREDI Main index falls from 49.6 to 48.6. Although the Current Situation index remains above the 50-mark, banks and property companies agree that the credit market is expected to have a weaker development in the future.

Main index components

The CREDI Main index fell from 49.6 to 48.6 in the December survey of CREDI, making it the second consecutive quarter where the CREDI survey indicates a slightly worsening credit market. The CREDI survey suggests that the credit market for property companies remains fairly stable, although slightly less so than in the preceding 12 months.

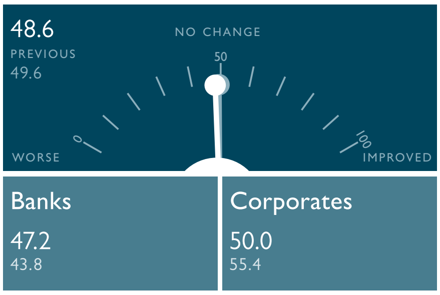
As has been the case since the CREDI survey conducted in September 2017, respondents have a positive view of the current situation of the credit market while maintaining a more negative view of the future development of the credit market. In the December survey, the Current Situation index fell from 53.7 to 52.2 while the Expectations index fell from 45.4 to 45.1. As such, the surveyed banks and property companies believe that the credit market has improved over the past three months, but that it will worsen over the next three months. In addition, the surveyed banks and property companies believe that taken as a whole the credit market has worsened slightly since the October survey was conducted.

Another interesting takeaway from the December survey is that banks and property companies are more or less in agreement on the state of the credit market, with the banks being slightly more optimistic about the current situation while being slightly more pessimistic about the future development.

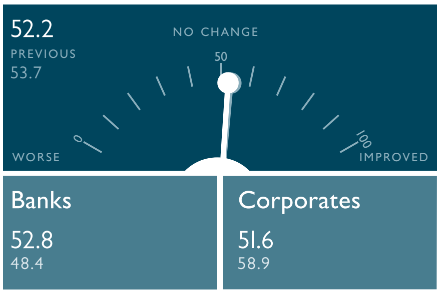
Sub-indices

The CREDI Main index is made up of eight underlying sub-indices. In the December survey, the Current Situation index was improved by lowered credit margins and extended credit durations, but also took a hit from reduced credit availability and leverage. With regard to the Expectations index, credit margins are expected to increase substantially and credit availability is expected to fall. However, the Expectations index benefits from an optimistic view on credit duration.

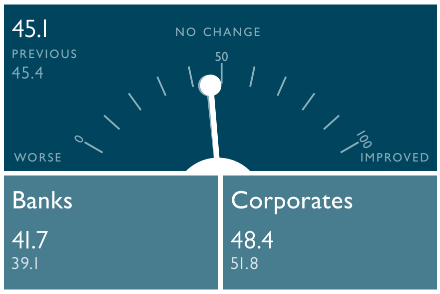
CREDI Main index



Current Situation



Expectation

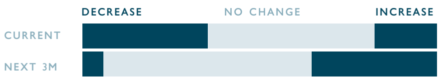


CREDI sub-indices

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.

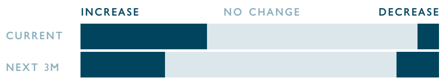
CREDIT AVAILABILITY

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.

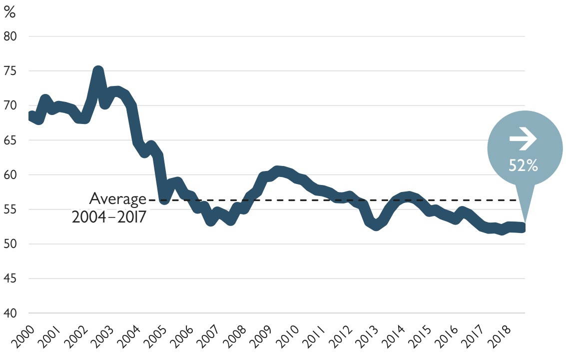
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a “no change”-answer equals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

The interim reports for the third quarter of 2018 indicate that property companies have seen a fairly stable credit market, with lower interest rates and reduced fixed credit terms.

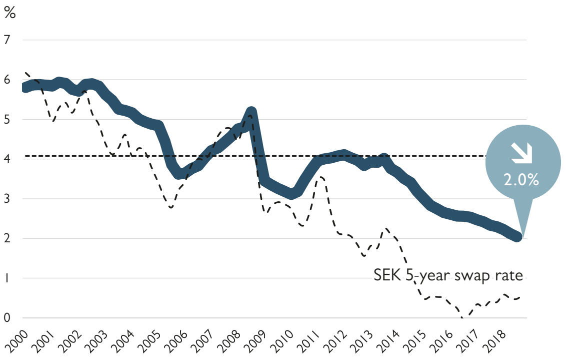
Listed sector Q3 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market remained at 52 per cent for the sixth consecutive quarter, and thus stays below the historical average of 56 per cent.

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

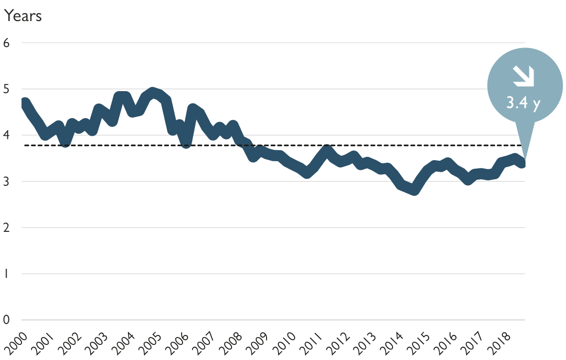
Listed sector Q3 average interest rate[2]



The average interest rate of listed property companies fell from 2.1 per cent to 2.0 per cent in the third quarter. This is, again, the lowest average interest rate in the history of CREDI. Sagax lowered their interest rate considerably from 2.9 per cent to 2.4 per cent, following an issue of EUR 500 million in bonds. In addition, Fabege has lowered their interest rate by an impressive 0.8 percentage points over the past two quarters.

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

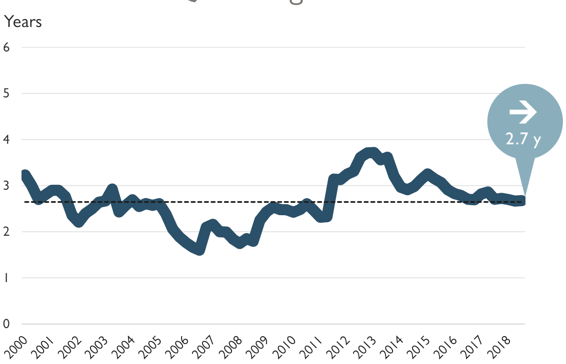
Listed sector Q3 average fixed credit term[3]



The average fixed credit term among listed property companies fell from 3.5 years to 3.4 years in the third quarter of 2018, slightly below the long-term average of 3.8 years. Around one third of the listed property companies extended their fixed credit terms during the quarter.

3 Average maturity referring to interest-bearing debt.

Listed sector Q3 average fixed interest term[4]



-------- Average 2000–2018

The average fixed interest term among listed property companies remains at 2.7 years for the fifth consecutive quarter, close to the long-term average of 2.6 years. This indicates that property companies believe that interest rates have bottomed out.

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.

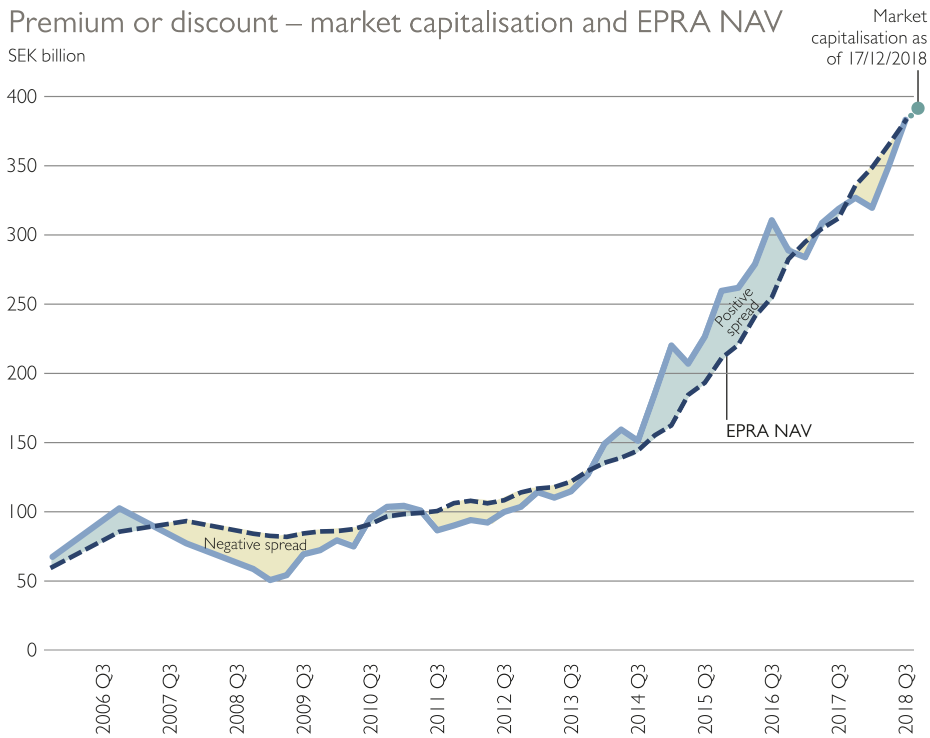
Common shares

At the end of the third quarter of 2018, listed property companies were trading at a slight premium as the stock market values assets and net operating income higher.

Property companies listed on Nasdaq Stockholm Main Market were trading at a slight premium at the end of the third quarter of 2018. Market capitalisation increased from SEK 350 billion to SEK 383 billion, while the property companies' EPRA NAV increased from SEK 365 billion to SEK 383 billion. This means that the market discount turned into a premium during the quarter. This trend has continued during the fourth quarter of 2018, as market capitalisation has reached approximately SEK 386 billion as of 17 December 2018.

Premium or discount – market capitalisation and EPRA NAV

SEK billion

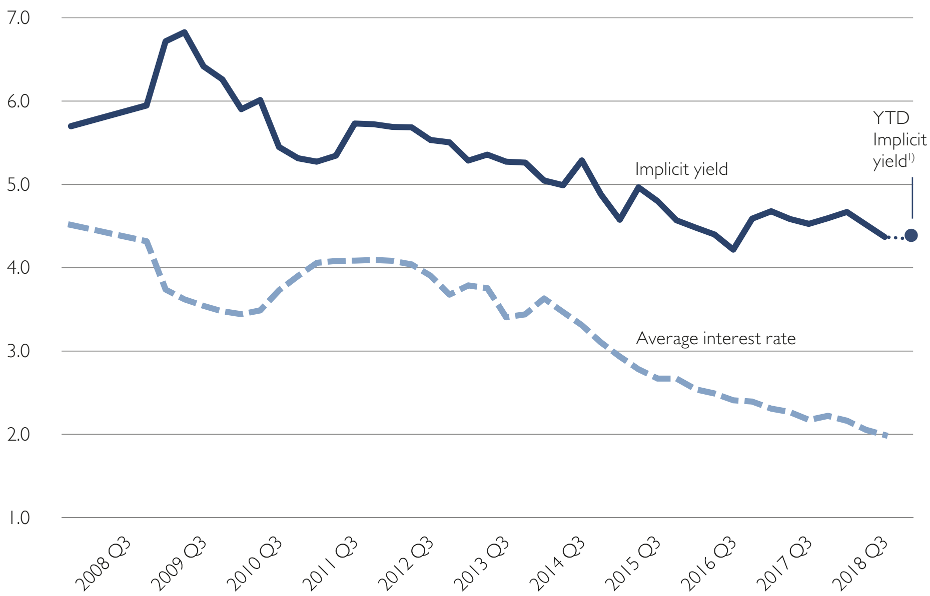


Note. Property companies on Nasdaq Stockholm Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

During the third quarter of 2018, the implicit yield of listed property companies decreased from 4.5 per cent to 4.4 per cent, which indicates that the stock market is valuing property companies' net operating income higher. In addition, as the stock market is appearing to be fairly unchanged in the fourth quarter of 2018, the year-to-date implicit yield remains at 4.4 per cent as of 17 December 2018. The gap between listed property companies implicit yield and their average interest rate is now approximately 2.4 per cent, which is a historically wide gap.

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

Per cent



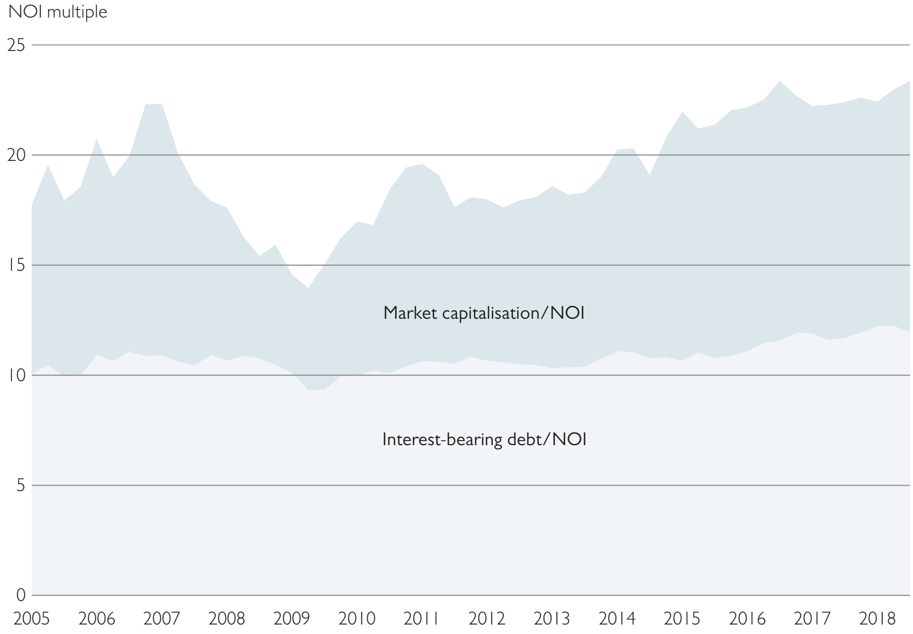
[1] Market values 17/12/2018 and 2018 Q3 EPRA NAV.

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.

Interest-bearing debt fell from 12.2 to 12.0 times net operating income in the third quarter of 2018, while market capitalisation increased from 10.7 to 11.4 times net operating income. In recent years, the credit market has adjusted its 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. The historically wide yield gap between the implicit yield of companies' investment properties and average interest rate implies a significant interest rate sensitivity for equity as well, should the yield gap revert back to its historical average.

Interest-bearing debt and market capitalisation in relation to NOI



Note. Property companies on Nasdaq Stockholm Main Market.

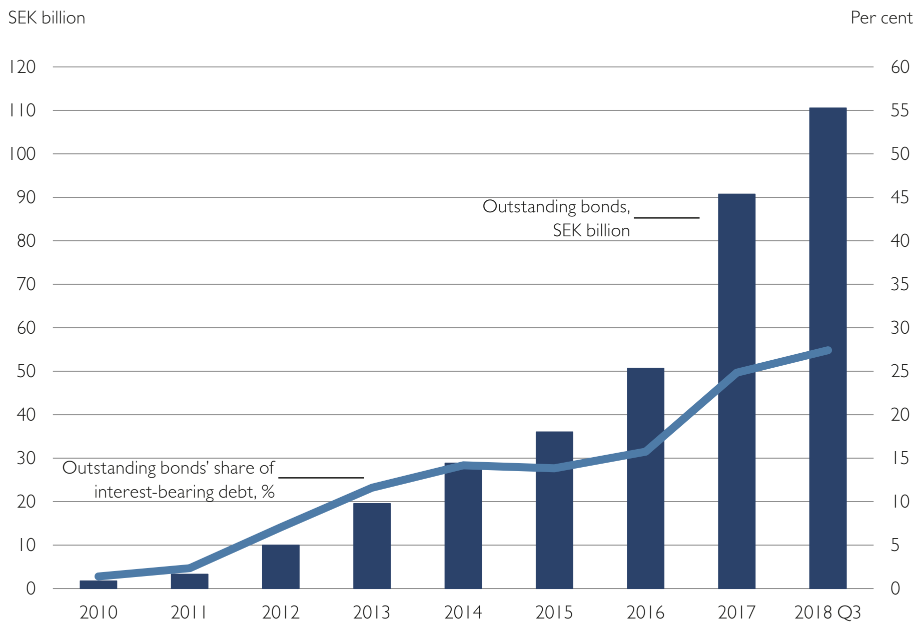
Bonds

Following a significant bond issue by Sagax, the volume of outstanding corporate bonds increased by 8 per cent in the third quarter of 2018.

The market for property-related corporate bonds has been relatively inactive in 2018, but there was a slight upswing in the market in the third quarter of 2018 as the volume of outstanding bonds issued by property companies listed on Nasdaq Stockholm Main Market increased by 8 per cent from SEK 102 billion to SEK 111 billion. This increase is largely attributable to Sagax issuing a EUR 500 million bond on the European bond market.

As such, corporate bonds remain popular, with the outstanding volume increasing by 22 per cent over the first three quarters of the year. Nevertheless, in 2017 the volume had increased by 62 per cent over the same period of time. Furthermore, corporate bonds' share of interest-bearing debt has been fairly stable throughout the year, although their share increased slightly from 26 per cent to 27 per cent in the third quarter of 2018.

Outstanding bonds

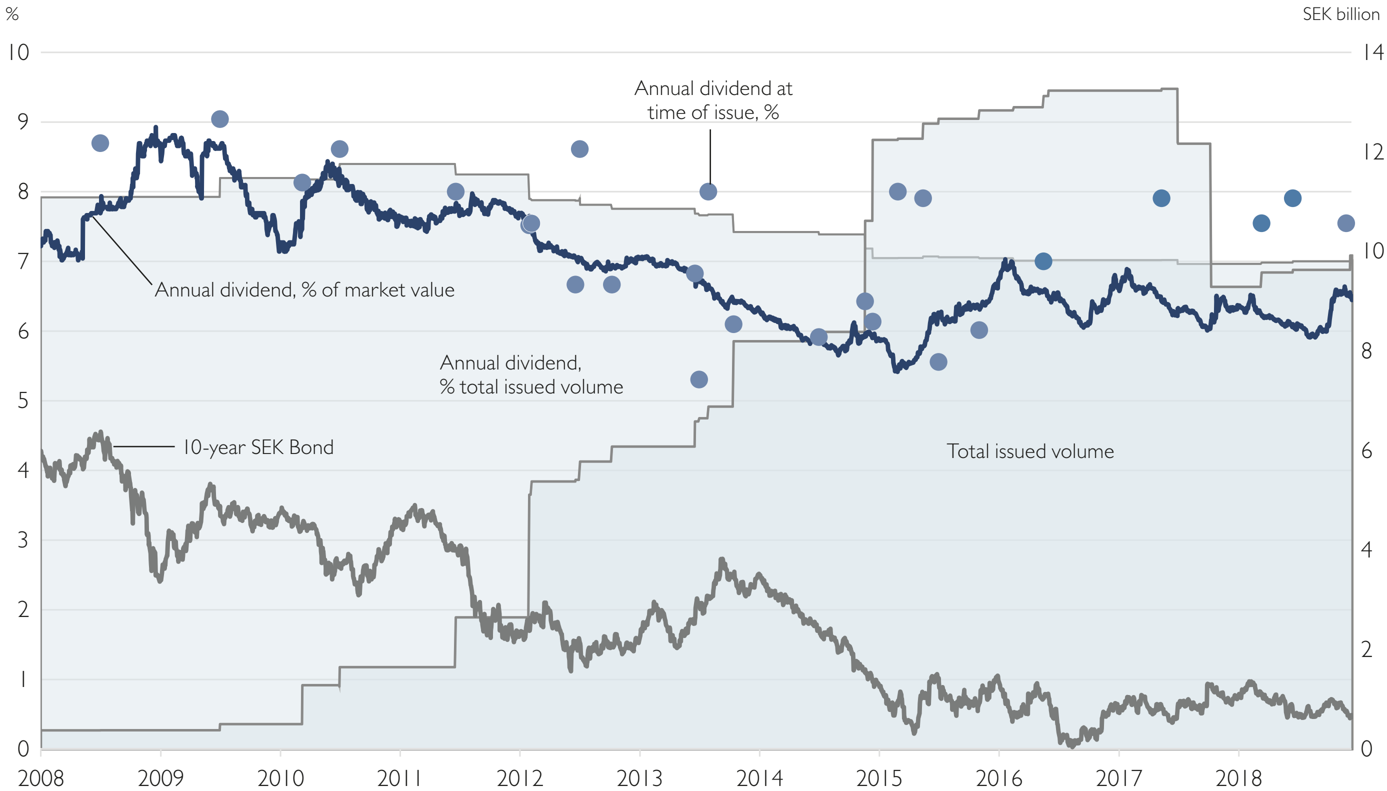


Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The secondary market for property-related preference shares has taken a substantial hit in the fourth quarter of 2018, as the average dividend increases from 6.0 to 6.5 per cent.

Property companies' preference shares on Nasdaq Stockholm Main Market



The primary market for property-related preference shares on Nasdaq Stockholm Main Market has been fairly eventful in 2018, with three new issues throughout the year, most recently when NP3 issued more than SEK 300 million in new preference shares. However, the secondary market has taken a notable hit at the end of the year.

In late September 2018, preference shares had an average dividend of approximately 6 per cent. However, following a fall in the stock market, these preference shares are trading at an average dividend of 6.5 per cent as of 17 December 2018. As such, it is becoming increasingly expensive for property owners to raise capital by issuing preference shares.

As has been discussed in previous CREDI reports, a number of property companies have sought alternatives to preference shares in order to improve their credit rating. For example, Balder redeemed all of their preference shares and replaced them with hybrid bonds, while Sagax launched its class D common share as an alternative. This strategy has now been adopted by Samhällsbyggnadsbolaget i Norden, listed on Nasdaq First North, which during the autumn of 2018 offered investors to have their preference shares redeemed in exchange for class D common shares. The company also announced that they are seeking to delist their remaining preference shares following the redemption.

Nevertheless, there are other companies in the property industry that have raised capital by issuing preference shares. Most notably, residential developer Aros Bostad issued SEK 24.5 million in preference shares on Nasdaq First North in November 2018, offering an initial dividend of approximately 8.7 per cent annually. As such, some companies continue to see benefits in preference shares.

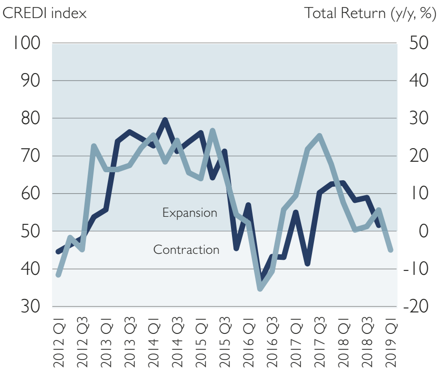
Catella's view through the looking glass

The economic cycle is entering its final phase and the credit sentiments among the property companies have weakened significantly. However, strong demand from core investors indicate a strong demand for well-located properties in the major cities for yet some time.

The Swedish equity market is a strong leading indicator of the CREDI Current Situation index for property owners. The equity market has fallen back significantly during the autumn, which indicates worsened credit sentiments in the coming quarters. The credit sentiments among banks have, however, improved somewhat lately. During the late autumn, investors have become increasingly more sceptical of high-risk corporate bonds and have sold ETFs that track the high-yield bond market in the US, while the cost of insurance against defaults has increased. Moreover, both high-yield and investment-grade credit default swap indices have risen in recent weeks. There are also signs that this has affected the market for Swedish corporate bonds, where interest rate margins have risen in a number of large issues in the past weeks. Transaction activity has slowed down considerably on the property market during the autumn, and investors have become increasingly selective with regard to the location and quality of the properties. The demand for prime offices in Stockholm, however, has gone from high to extremely high in recent months. International investment managers are leading the bidding rounds, but Swedish private and listed actors are also staying competitive.

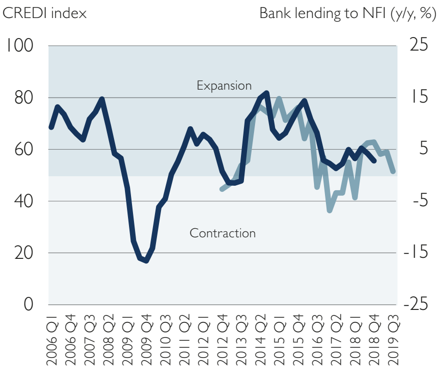
The development on the property market mirrors the development on the stock market, lagging approximately 12–18 months behind. The global stock markets are now likely facing an extended bear market as the Fed's previous tightening of its monetary policy is starting to take effect at the same time as the positive effects of the Trump administration's tax cuts and the global economic growth are becoming weaker. As such, the market has become increasingly more doubtful with regard to how much the large central banks will actually tighten their policies. Nevertheless, the direction for the Swedish property market will likely be a combination of slightly higher interest rates and a wider gap in interest rate margins between companies with different credit ratings. However, the weak economic growth will probably entail continued low interest rates for an extended period of time.

CREDI Current Situation and OMX Sthlm 30



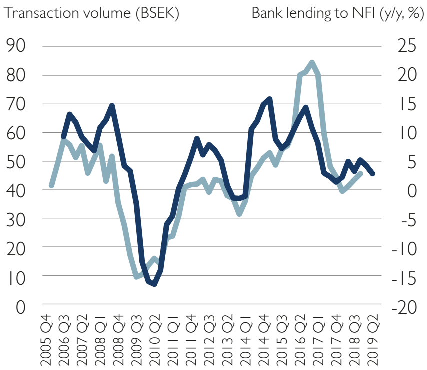
CREDI Current situation, Property owners
OMX Stockholm 30, Total Return, 1 quarter ahead (y/y, %)

CREDI Current Situation and bank lending



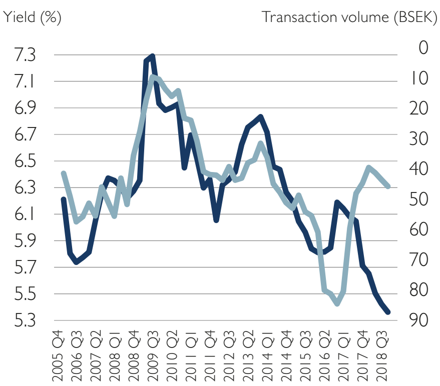
CREDI Current situation, Property owners, 3 quarters ahead
Bank lending to Non Financial Institutions with commercial property as collateral (y/y, %)*

Transaction volume and bank lending



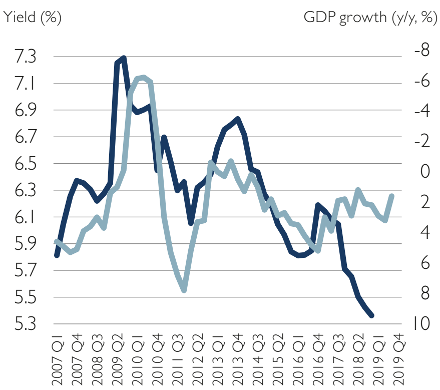
Transaction volume, office and retail properties, rolling 12months
Bank lending to Non Financial Institutions with commercial property as collateral, 2 quarters ahead (y/y, %)

Average property yields* and transaction volume



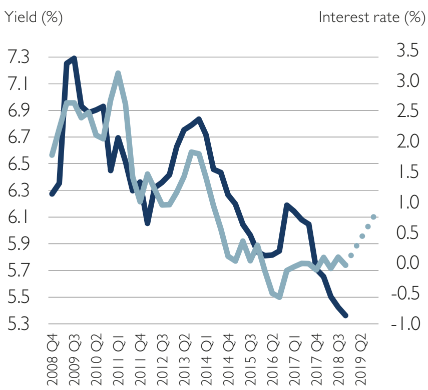
Yield, office and retail properties, 12 months rolling average
Transaction volume, office and retail properties, rolling 12months

Average property yields* and GDP growth



Yield, office and retail properties, 12 months rolling average
GDP growth, 4 quarters ahead (y/y, %)

Average property yields* and interest rates



Yield, office and retail properties, 12 months rolling average
Sweden Benchmark Bond - 5 Year

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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Catella is a European financial advisor and asset manager. In Sweden, Catella is a market leader 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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