CATELLA

CRED>I

CATELLA REAL ESTATE DEBT INDICATOR

CREDI March 2019

Credit market improves as optimism rises among property companies

In the March issue of CREDI the Main index increases from 48.6 to 50.3, indicating a slightly improved credit market. Property companies maintain a positive view of the credit market as interest rates fall to a new record low, while banks show increasing signs of wariness.

THE CREDI SURVEY INDICATES A REBOUND IN THE CREDIT MARKET

The March survey shows that access to credit has improved, while credit margins have increased. Overall, the credit market has improved despite divided opinions among respondents.

INCREASED OPTIMISM AMONG PROPERTY COMPANIES

The CREDI Main index for property companies increased from 50.0 to 56.8, driven by the strongest Expectation index in nearly four years. The overall credit sentiment among property companies improved while the sentiment among banks took a downturn.

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 last quarter of 2018, the average interest rate fell to 1.9 per cent, which is the lowest rate observed in the history of CREDI.

GROWTH IN VOLUME OF BONDS APPEARS TO HAVE LEVELLED OUT

The bond market in 2018 failed to maintain the growth observed in the record year of 2017. Nevertheless, the volume of bonds among property companies increased by 28 (79) per cent.

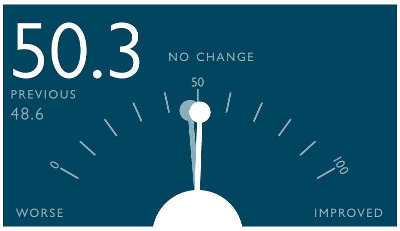
STOCK MARKET TRADED AT A DISCOUNT AT END OF YEAR

The stock market faced headwinds in the fourth quarter and property companies' shares shifted towards trading at a discount at the end of the year. However, in 2019, the stock market has bounced back and shares appear to be trading at a premium yet again.

MARKET FOR PREFERENCE SHARES HAS RECOVERED IN 2019

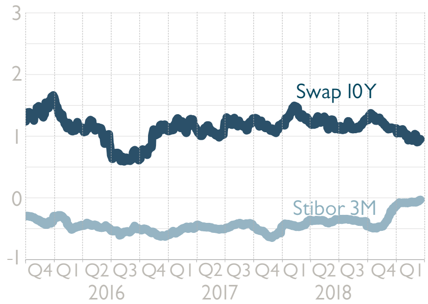
Property-related preference shares struggled at the end of 2018, as the average dividend on the secondary market increased to 6.6 per cent. Following the recovery in 2019, preference shares are currently trading at around 6 per cent.

CREDI Main index



Banks	Corporates
43.8	56.8
47.2	50.0

Swedish key interest rates, 2015–2019. Per cent



Loan-to-value Q4 average → 52%	Interest rate Q4 average ↘ 1.9%	Fixed credit term Q4 average ↗ 3.6 y	Fixed interest term Q4 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.

The CREDI Survey

In the March survey of CREDI, the Main index increases from 48.6 to 50.3, thus ceasing the trend where the CREDI survey indicates a slightly worsening credit market.

Main index components

The CREDI survey suggests that the credit market remains fairly stable by now passing the 50-mark, notably displaying a marginal improvement.

As has been the case for the past one and a half years, respondents have a positive view of the current situation of the credit market while maintaining a more negative view of its future development. In the March survey, the Current Situation index remains at 52.2 while the Expectations index increases from 45.1 to 48.4. As such, the synthesized belief of the property market is that the credit market has improved over the past three months, but that it will worsen slightly over the next three months.

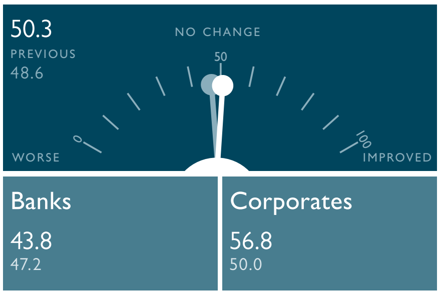
An interesting takeaway from the March survey is that banks and property companies display increasingly divided opinions on the state of the credit market. Contrary to the CREDI survey in December, banks are now less optimistic about the current situation than property companies are. Notably, the banks' Current Situation index plunged from 52.8 to 47.5, while property companies' hiked from 51.6 to 56.8. Continuing on the theme of divided opinions, the banks' Expectation index fell from 41.7 to 40.0 while the property companies' soared from 48.4 to 56.8. The difference translates to banks being less optimistic about the future while property companies expect to reap benefits from future tailwinds in the credit market.

Sub-indices

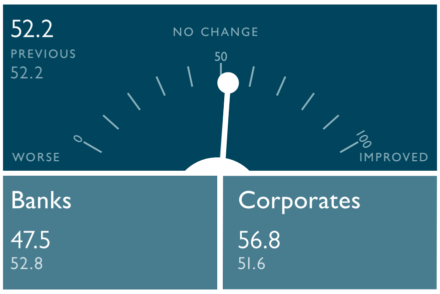
The CREDI Main index is made up of eight underlying sub-indices. In the March survey, the Current Situation index was improved by increased credit availability and extended credit durations, but also experienced a downturn from expanded credit margins and reduced leverage.

With regard to the Expectations index, credit duration and credit availability are expected to increase marginally. However, the Expectations index is facing headwinds from an unfavourable view on leverage and credit margins.

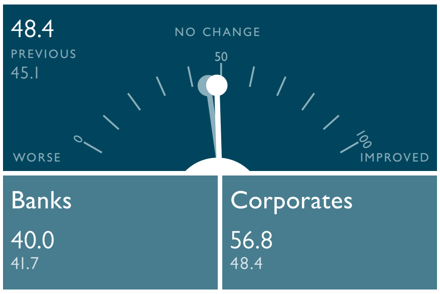
CREDI Main index



Current Situation



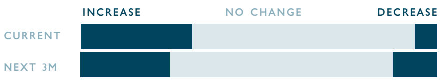
Expectation



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.

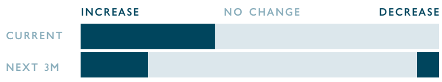
CREDIT AVAILABILITY



LEVERAGE

CREDIT MARGINS

DURATION



ABOUT THE CREDI SURVEY

CREDI is a market sentiment indicator for the Swedish real estate debt financing market. The indicator is based in part on a quarterly current and forward-looking survey of Swedish listed property companies, and banks providing real estate financing on the Nordic market. 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.

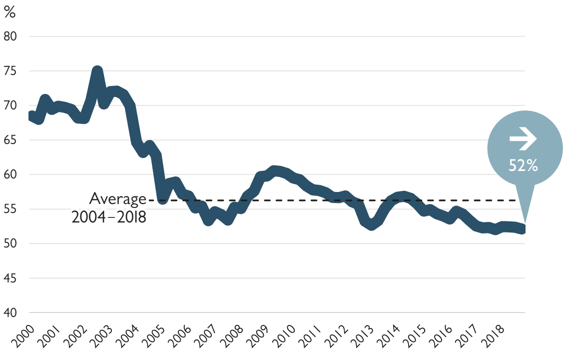
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 last quarter of 2018 indicate that property companies have seen a slightly augmented credit market, with lower interest rates and extended fixed credit terms.

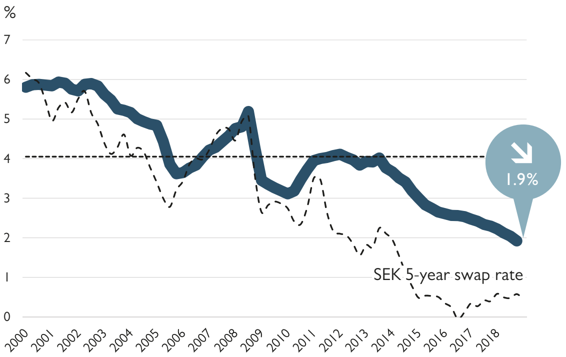
Listed sector Q4 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market remained at 52 per cent for the seventh 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.

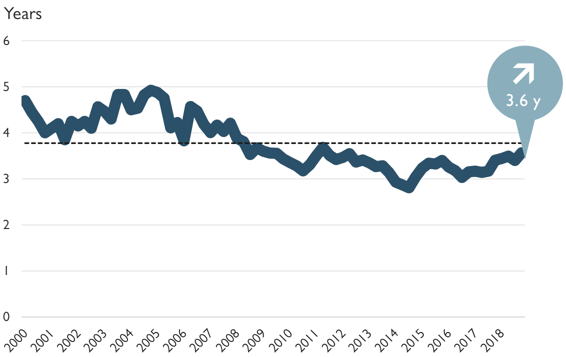
Listed sector Q4 average interest rate[2]



The average interest rate of listed property companies fell from 2.0 per cent to 1.9 per cent in the fourth quarter. This is, again, the lowest average interest rate in the history of CREDI. Wihlborgs lowered their interest rate considerably from 2.4 per cent to 1.4 per cent, following a restructuring of their derivatives portfolio. In addition, Platzer has lowered their interest rate by an impressive 0.6 percentage points since the previous quarter.

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

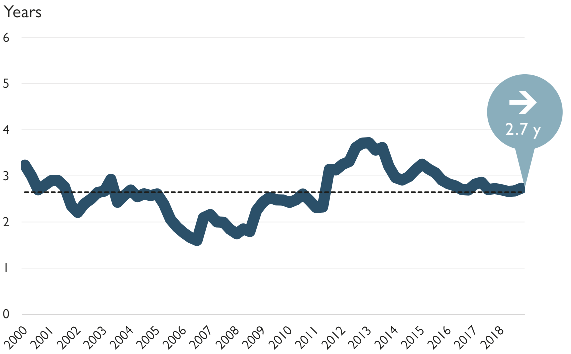
Listed sector Q4 average fixed credit term[3]



The average fixed credit term among listed property companies increased from 3.4 years to 3.6 years in the last quarter of 2018, slightly below the long-term average of 3.8 years. More than 50 per cent of the listed property companies extended their fixed credit terms during the quarter.

3 Average maturity referring to interest-bearing debt.

Listed sector Q4 average fixed interest term[4]



-------- Average 2000–2018

The average fixed interest term among listed property companies remains at 2.7 years for the sixth 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 QI 2000.

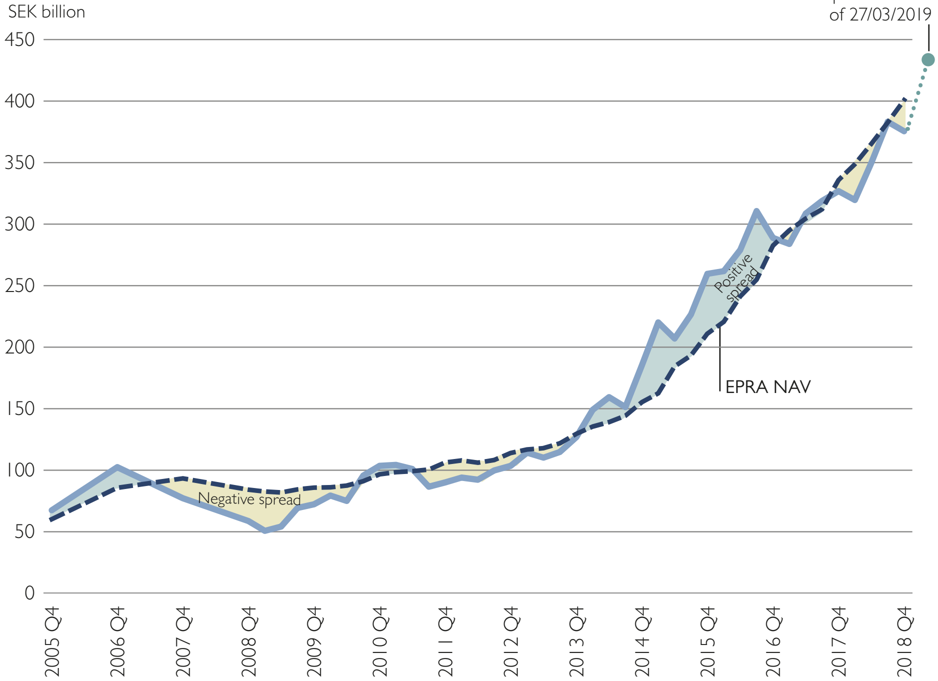
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

The last quarter of 2018 illustrated the effects of quantitative tightening and trade wars, where the stock market valued assets and net operating income lower. Nevertheless, the stock market has recovered considerably during 2019.

The listed shares of property companies on Nasdaq Stockholm Main Market were facing macroeconomic headwinds in the last quarter of 2018. This resulted in a valuation downturn where the former market premium shifted towards a discount at the end of 2018. Market capitalisation decreased from SEK 383 billion to SEK 375 billion, while the property companies´ EPRA NAV increased from SEK 382 billion to SEK 401 billion.
In the first quarter of 2019, the market has bounced back attributable to a more dovish interpretation of the Federal Reserve's monetary policy and hopes of an ending trade war. As of now, property companies appear to be traded at a premium with an aggregated market capitalisation of SEK 439 billion.

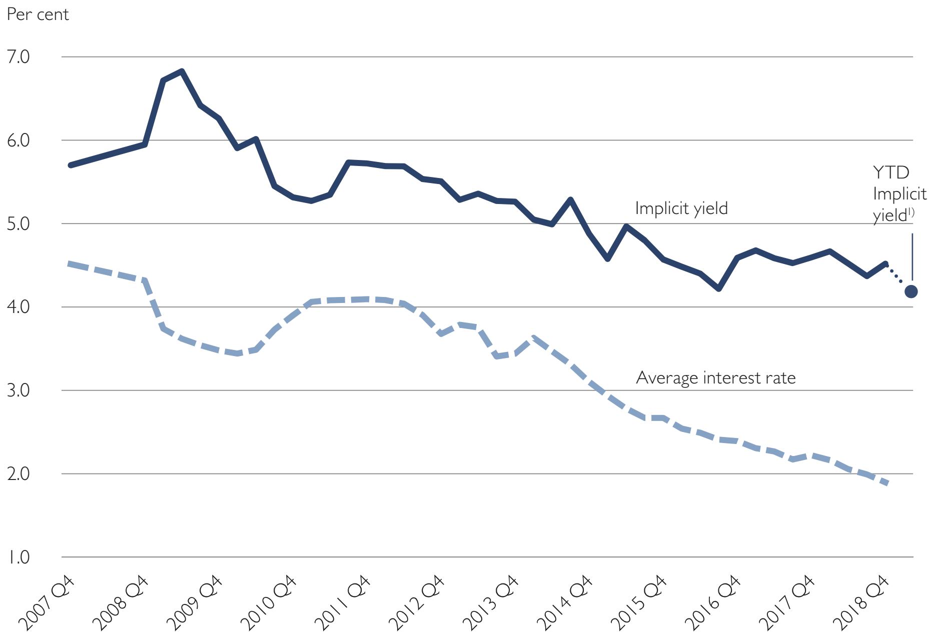
Premium or discount – market capitalisation and EPRA NAV



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.

In the last quarter of 2018, the implicit yield of listed property companies increased from 4.4 per cent to 4.5 per cent, which indicates that the stock market valued the property companies´ assets lower. Moving forward, the year-to-date implicit yield has plunged to 4.2 per cent as of 27 March 2019, a result of the stock market's strong recovery in the first quarter of 2019. The spread between listed property companies implicit yield and their average interest rate is now approximately 2.6 per cent, which is a historically wide spread.

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



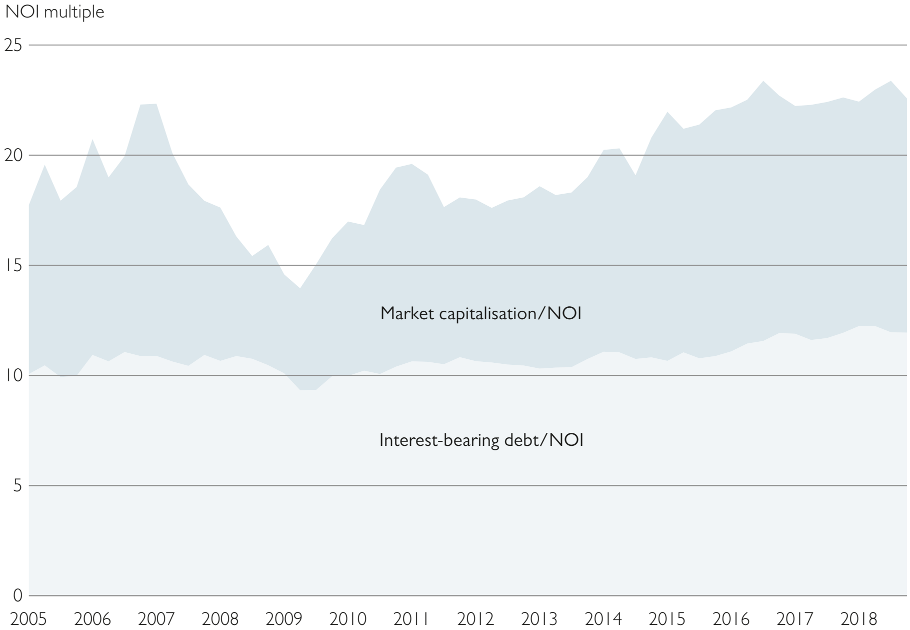
[1] Market values 27/03/2019 and 2018 Q4 EPRA NAV.

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 decreased slightly from 12.0 to 11.9 times net operating income in the last quarter of 2018, while market capitalisation suffered a more significant hit from 11.4 to 10.6 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.

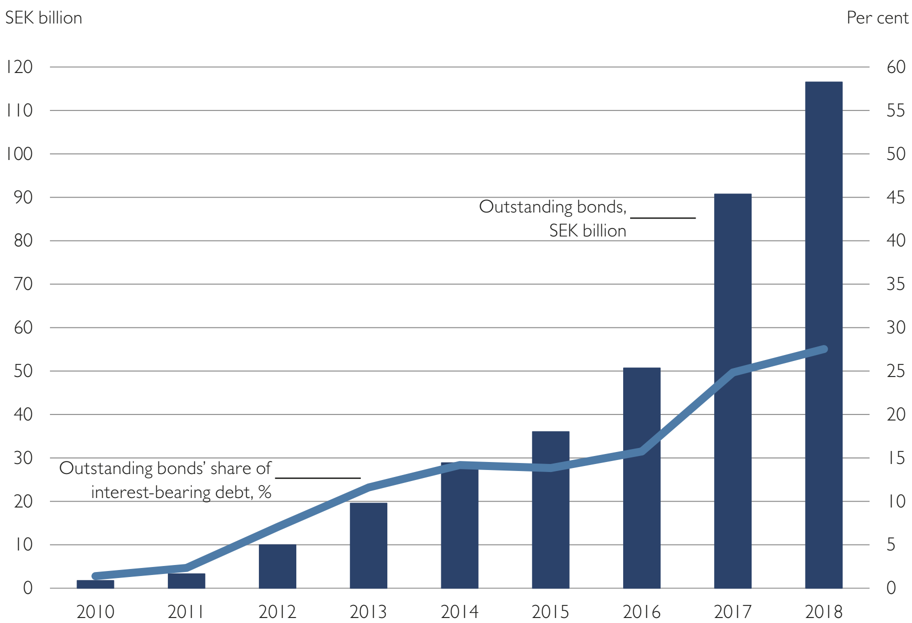
Bonds

By the end of 2018, it was evident that the growth in volume of outstanding property-related corporate bonds has levelled out.

In 2018, the market for property-related corporate bonds has been relatively inactive, where existing growth can be attributed to a few albeit large issues. In the fourth quarter of 2018, the volume of outstanding corporate bonds increased by 5.1 per cent from SEK 111 billion to 116.5 billion. This increase is largely attributable to Castellum issuing a EUR 500 million bond on the European bond market. Other property companies that have been active during the year include Kungsleden, Sagax and Fabege.

As such, corporate bonds remain popular, with the outstanding volume increasing by 28 per cent over the year. Nevertheless, in 2017 the volume had increased by 79 per cent over the same period of time. Furthermore, corporate bonds' share of interest-bearing debt seems to have stagnated at 27.5 per cent.

Outstanding bonds

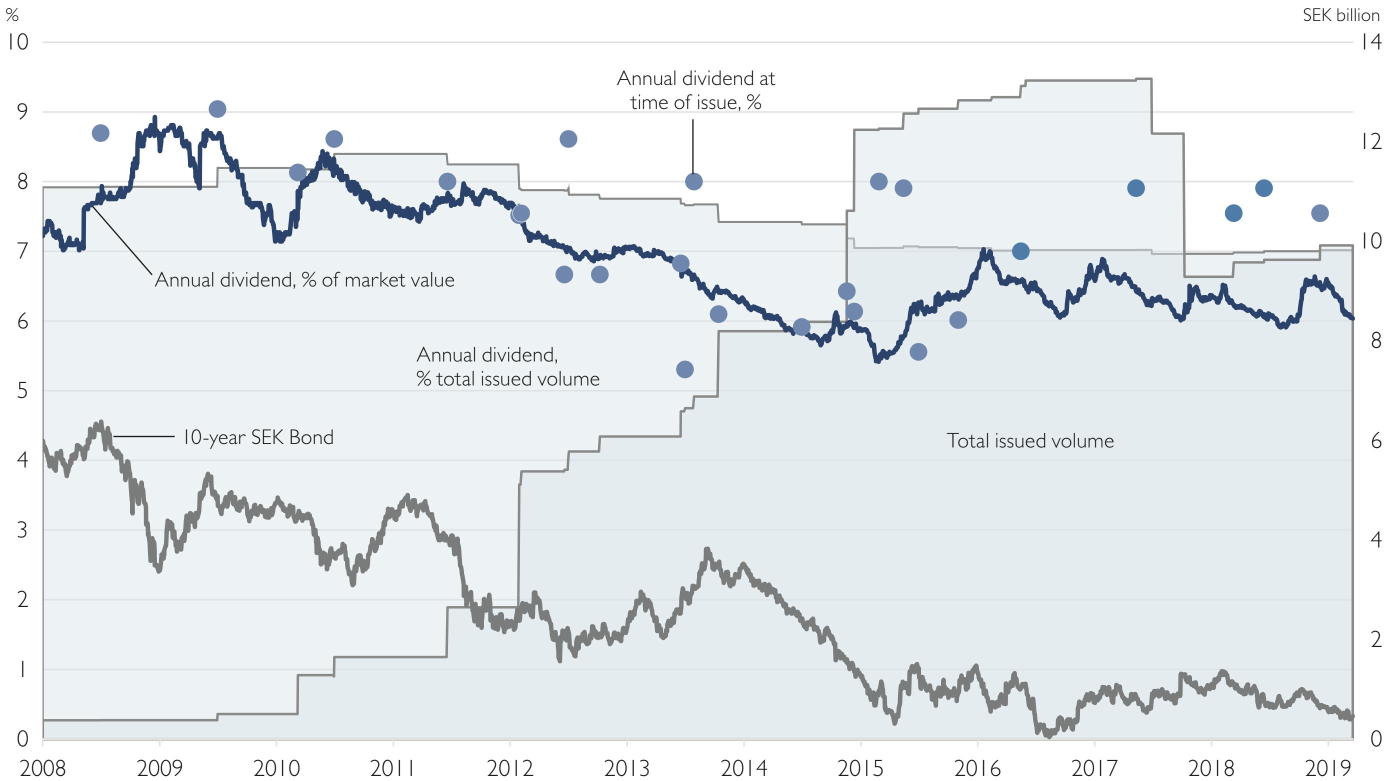


Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The secondary market for property-related preference shares has ricochet from the downturn in the fourth quarter of 2018, as the average dividend decreases from 6.6 per cent to 6.0 per cent.

Property companies' preference shares on Nasdaq Stockholm Main Market



During the fourth quarter of 2018, in conjunction with the general downturn of the stock market, the secondary market for property-related preference shares took a notable hit where the average dividend peaked at 6.6 per cent. Moving into 2019, the market ricochet and is now trading at an average dividend of 6.0 per cent as of 27 March 2019. As such, the market shift indicates that investors value preference shares with a lower risk premium.

Looking back, 2018 was a relatively stable year for property-related preference shares on Nasdaq Stockholm Main Market, compared to a volatile 2017 where the market volume decreased by more than 30 per cent. In 2018, the primary market was fairly eventful, with three new issues throughout the year. Most notably, NP3 issued approximately SEK 288 million in new preference shares during the spring. Also, Oscar Properties issued SEK 32 million of its class A preference shares to Skandrenting.

Furthermore, the previously recognized trend where property companies have sought alternatives to preference shares in order to improve their credit rating has continued. The main driver has been that credit rating agencies in their rating models consider preference shares as partial debt. Following this trend, Sagax issued an additional SEK 302 million of its new high-yielding class D common share.

Also adopting to the trend, Samhällsbyggnadsbolaget i Norden offered investors to have their preference shares redeemed in exchange for class D common shares. With a clear goal of reaching an investment grade rating, the company further incentivised the switch to the class D common share by delisting their preference shares.

Going forward, this trend is expected to continue as credit ratings become increasingly important.

Catella's view through the looking glass

The equity market has rebound strongly, with the OMX 30 index up around 12 per cent since January. The main driver has been the U-turn of the major central banks in recent months, a result of weakening growth in the US and globally.

The Swedish equity market is a strong leading indicator of the CREDI Current Situation index for property owners. The equity market indicates stable credit sentiments in the coming quarters. Lower interest rates and improved risk willingness among investors are factors that have benefitted the Swedish property market and that have contributed to the strong start of the transaction year.

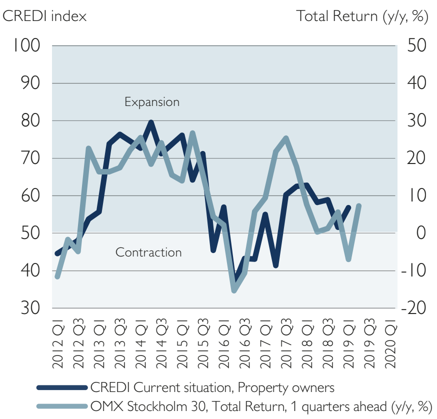
Going forward, Catella has identified two scenarios for the global economy that are of relevance for the future development of the Swedish property market.

In the first scenario, the global economy heads towards a downturn in 2019 and the US economy slows down to the potential growth rate of around 1.8 per cent year-on year during the rest of 2019. The 10-year US government bond yield dropping below the 3-month bill yield speaks in favour of this scenario. The Fed would then remain dovish and perhaps even start a new programme of QE. In this macro environment, the Riksbank will be able to pursue a continuously expansive policy to counterbalance the slowing domestic economy. Property total return would still move towards the underlying yield levels as rental growth slows down. The property companies' interest rate costs would, however, remain low or even decline further, which would keep transaction volumes up and yields down.

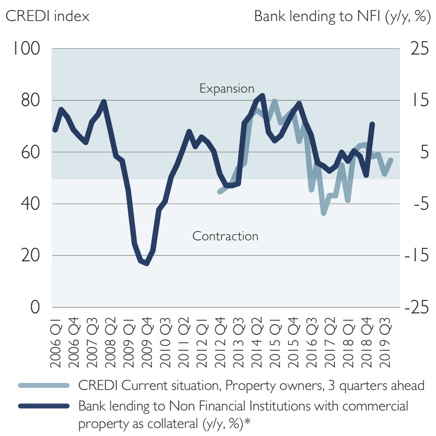
The second scenario is that the current dovish Fed and the recovering stock markets underpin a relatively healthy US GDP growth during the rest of 2019. In this scenario, the Fed will temporarily pause and then pick up the gradual monetary tightening after the summer, with gradually higher interest rates and further balance sheet reductions. The Riksbank will in this case need to follow the Fed and pursue a less expansive policy too.

Although the probabilities of the two scenarios are currently rather evenly distributed, Catella is leaning towards the second scenario as the most likely. In both cases, the weak economic growth will probably entail continued low real interest rates for an extended period of time, which will make property a continuously attractive asset class for private and institutional capital.

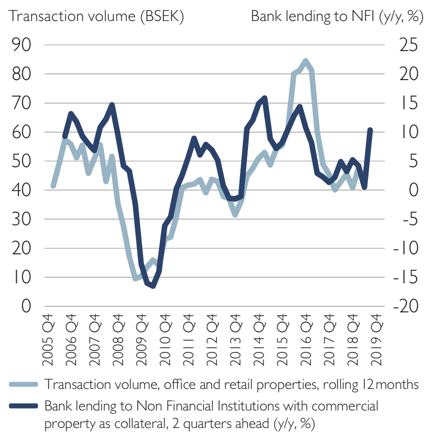
CREDI Current Situation and OMX Sthlm 30



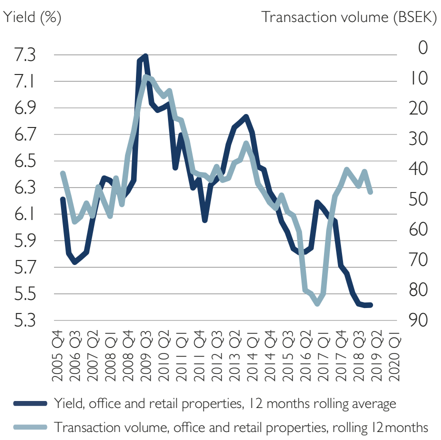
CREDI Current Situation and bank lending



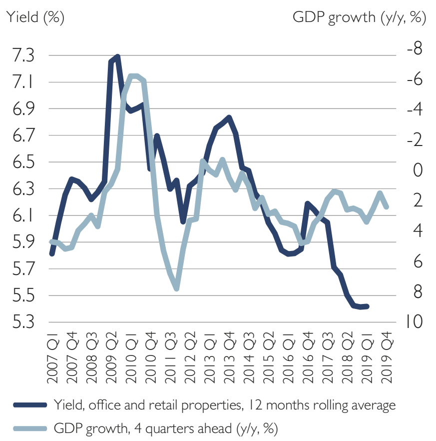
Transaction volume and bank lending



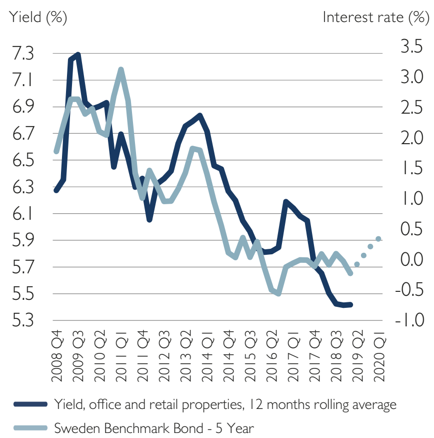
Average property yields* and transaction volume



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

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

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

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HQ: Birger Jarlsgatan 6, Stockholm info@catella.se
www.catella.com