CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

CREDI July 2019

Stable credit market as property companies' shares reach new high

In the July issue of CREDI, the Main index increases from 50.3 to 50.8 indicating a slightly improved credit market. Property companies maintain a positive view of the credit market, while banks are increasingly pessimistic about the future.

THE CREDI SURVEY REFLECTS A STABLE CREDIT MARKET

The July survey shows that access to credit has improved, while credit margins have decreased slightly. Consequently, the credit market remains stable.

INCREASED PESSIMISM AMONG BANKS GOING FORWARD

The CREDI Main index for banks increased from 43.8 to 44.8, driven by a surge in the Current situation index. However, banks are increasingly pessimistic as the Expectations index falls to its second-lowest point in the history of CREDI.

AVERAGE INTEREST RATE INCREASES MARGINALLY

In the first quarter of 2019, the average interest rate increased marginally to 2.0 per cent. This marked the end of the trend of decreasing interest rates that lasted for 21 quarters.

STRONG TAILWINDS AS SHARES TRADE AT A PREMIUM

Property companies' shares traded at a discount in the fourth quarter of 2018 after troublesome developments in the market, but the stock market recoiled in the first quarter of 2019.

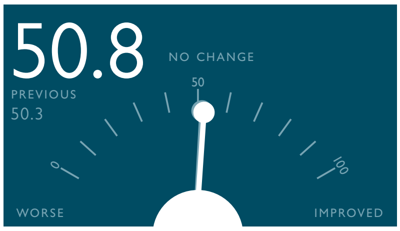
VOLUME-GROWTH IN BONDS CONTINUES TO SLOW DOWN

The volume of outstanding corporate bonds among property companies increased by 6.3 per cent (8.2) in the first quarter of 2019. Nevertheless, the bond market continues to slow down, and the bonds' share of interest-bearing debt has levelled out at 28 per cent.

MARKET FOR PREFERENCE SHARES HAS RECOVERED IN 2019

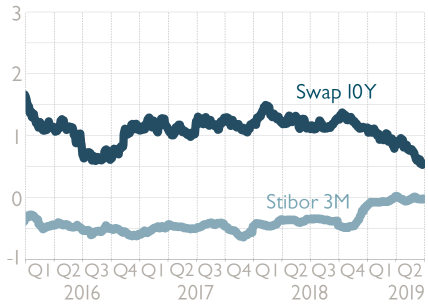
Property-related preference shares have revitalized in the first half of 2019, as the average dividend of preference shares on the secondary market decreases from 6.6 to 6.1 per cent.

CREDI Main index



Banks	Corporates
44.8	56.9
43.8	56.8

Swedish key interest rates, 2016–2019. Per cent



Loan-to-value Q1 average	Interest rate Q1 average	Fixed credit term Q1 average	Fixed interest term Q1 average
↗ 54%	↗ 2.0%	→ 3.6 y	↗ 2.8 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

The CREDI Main index increases from 50.3 to 50.8, suggesting a slightly improved credit market in the July survey of CREDI. As the Current Situation index increases and the Expectation index decreases, banks and corporates boast divided opinions.

Main index components

In the July survey of CREDI, the Main index increases from 50.3 to 50.8, continuing the trend where the CREDI survey indicates a slightly improved credit market. The CREDI survey suggests that the credit market remains fairly stable considering the index exceeds the 50-mark.

As has been the case for almost two 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 July survey, the Current Situation index increases from 52.2 to 55.8 while the Expectations index decreases from 48.4 to 45.8.

An interesting takeaway from the July survey is that banks and property companies continue to display divided opinions on the state of the credit market. Much like the CREDI survey in March, banks are less optimistic about the current situation than property companies are.

However, their perceptions have converged as the banks' Current Situation index hiked from 47.5 to 54.2, while property companies' increased slightly from 56.8 to 57.5. On the other, hand both parties have dispersed as the banks' Expectation index fell further from 40.0 to 35.4 while the property companies' Expectation index saw a minor decrease from 56.8 to 56.3.

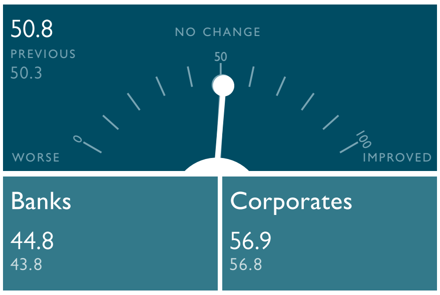
This difference translates to banks being less optimistic about the future while property companies are still expecting to harvest benefits from the credit market. Notably, the banks' expectation index is the second lowest it has ever been in the history of the CREDI Survey.

Sub-indices

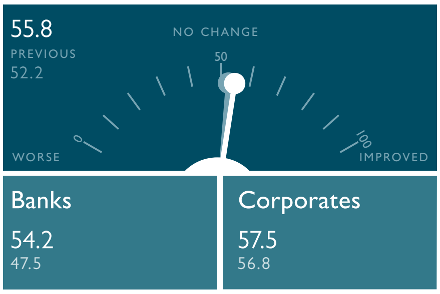
The CREDI Main index is made up of eight underlying sub-indices. In the July survey, the Current Situation index was improved by increased credit availability, lower credit margins and extended credit duration while the view on leverage appear to be unchanged since the previous survey took place.

With regard to the Expectations index, credit duration is expected to increase marginally while credit availability and leverage remain rather unchanged. However, the Expectations index faces headwinds from an unfavourable view on credit margins.

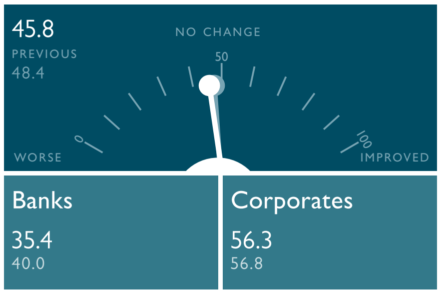
CREDI Main index



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.

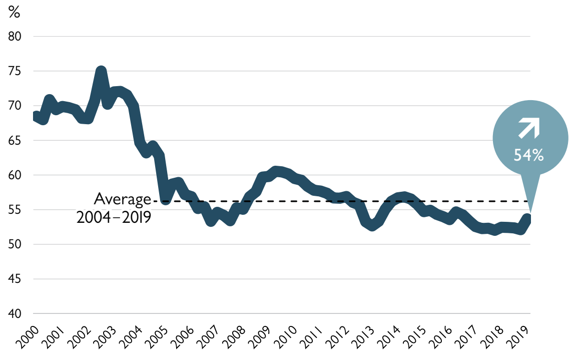
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 first quarter of 2019 indicate that property companies have seen a fairly stable credit market. However, long-term trends for loan-to-value, interest rates and interest terms appear to have come to an end.

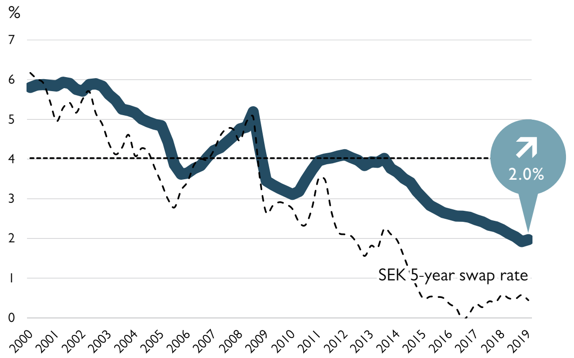
Listed sector Q1 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market increased slightly to 54 per cent, thus marking the end of a seven consecutive quarter trend of an invariable loan-to-value. Nevertheless, the current level remains below the historical average of 56 per cent.

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

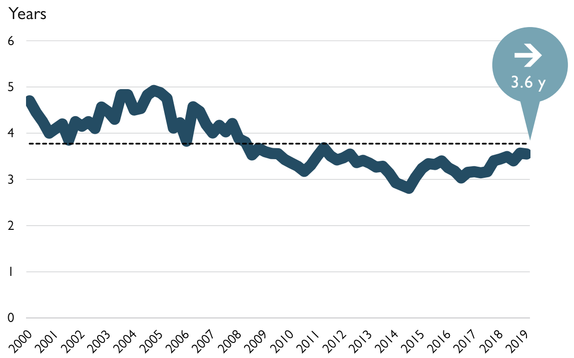
Listed sector Q1 average interest rate[2]



The average interest rate of listed property companies increased from 1.9 per cent to 2.0 per cent in the first quarter of 2019. This constitutes an important shift in the market, as it is the first time in nearly six years that the average interest rate has increased. However, interest rates remain at a low level and Hufvudstaden is the industry flag-bearer with an average interest rate of 1.2 per cent.

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

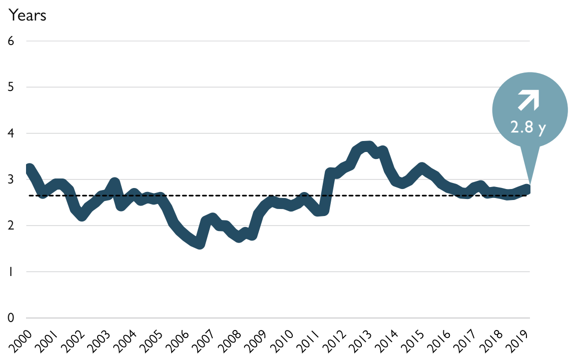
Listed sector Q1 average fixed credit term[3]



The average fixed credit term among listed property companies remained at 3.6 years in the first quarter of 2019, slightly below the long-term average of 3.8 years. More than 50 per cent of the listed property companies shortened their fixed credit terms during the quarter.

3 Average maturity referring to interest-bearing debt.

Listed sector Q1 average fixed interest term[4]



-------- Average 2000–2019

The average fixed interest term among listed property companies increased from 2.7 to 2.8 years, thus ceasing a six consecutive quarter trend of invariable fixed interest terms. The current interest term is slightly longer than 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.

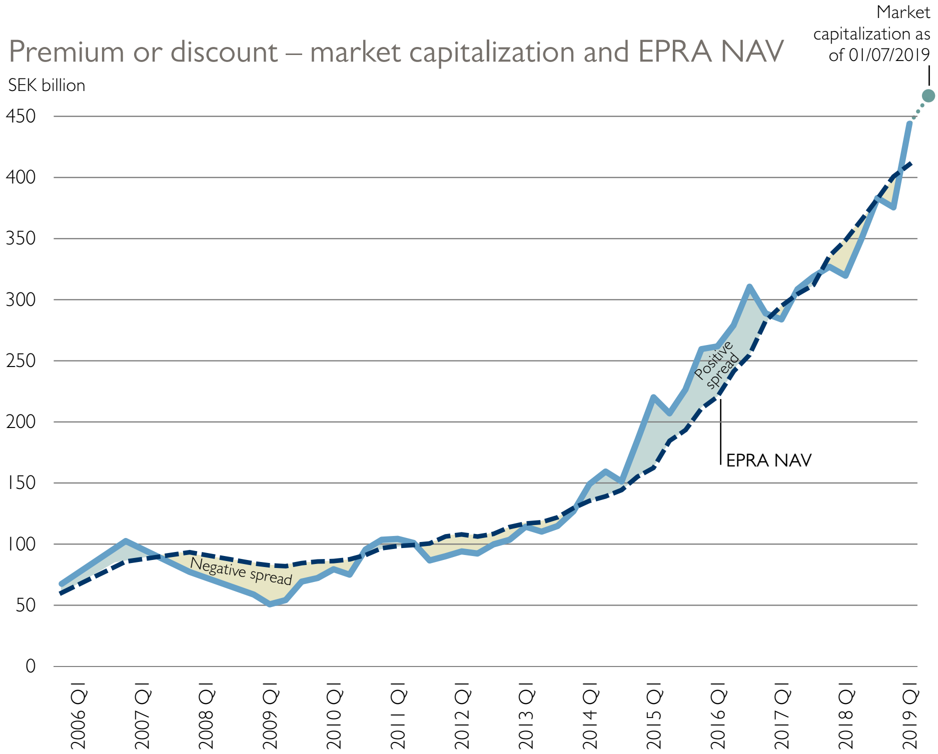
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

The first quarter of 2019 saw a strong comeback for property companies, as the stock market valued their assets and net operating income higher.

The market capitalization of the listed shares of property companies on the Nasdaq Stockholm Main Market soared as the markets responded to a more dovish interpretation of the Federal Reserve's monetary policy. The market now expects significant interest rate cuts going forward as macroeconomic indicators shift toward a more negative outlook, provoking valuation tail winds. Market capitalization increased from SEK 375 billion to SEK 444 billion, while the property companies' EPRA NAV increased from SEK 401 billion to SEK 411 billion. Thus, the former market discount has turned into a premium in the first quarter of 2019. As of 1 July 2019, the premium appears persistent with an aggregated market capitalization of SEK 465 billion year-to-date.

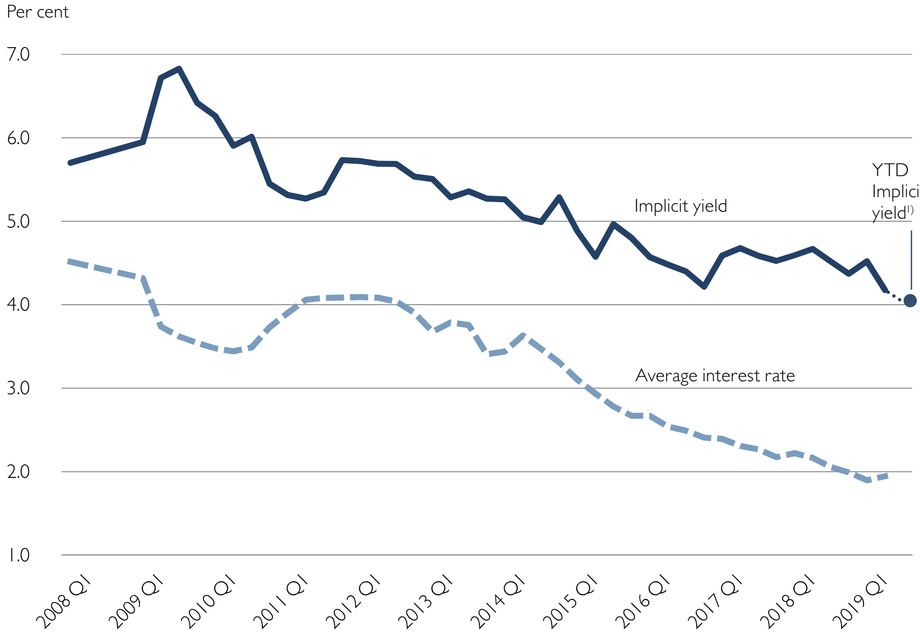
Premium or discount – market capitalization and EPRA NAV



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 first quarter of 2019, the implicit yield of listed property companies decreased from 4.5 per cent to 4.2 per cent, which indicates that the stock market values the property companies' assets higher. The spread between listed property companies implicit yield and their average interest rate is approximately 2.2 per cent, which is lower than the previous quarter's 2.6 per cent, but still a historically wide spread. Moving forward, the year-to-date implicit yield has descended further to 4.1 per cent as of 1 July 2019, a result of the stock market's strong performance.

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



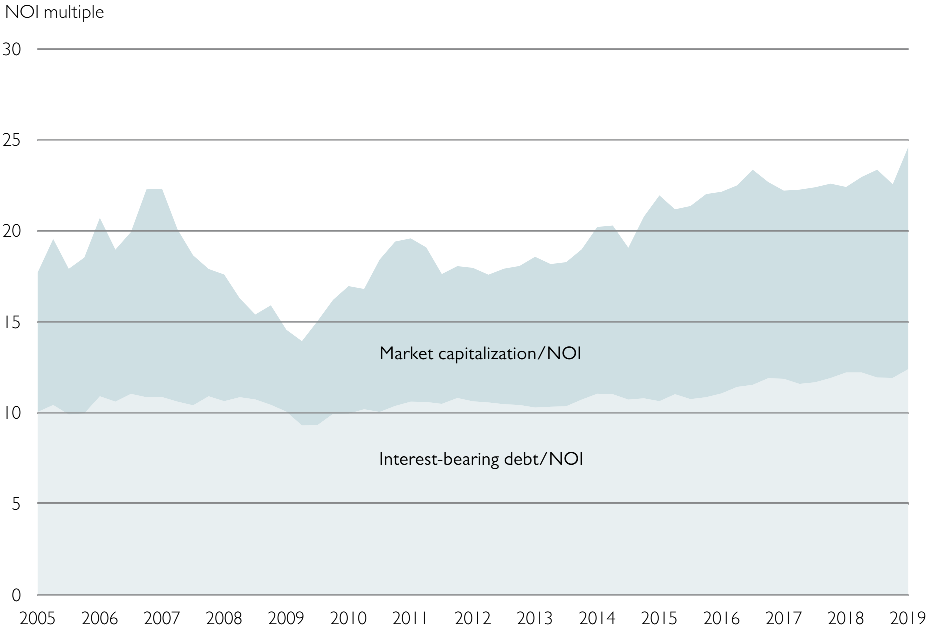
[1] Market values 01/07/2019 and 2019 Q1 EPRA NAV.

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 increased from 11.9 to 12.4 times net operating income in the first quarter of 2019, while market capitalization soared from 10.6 to 12.2 times net operating income. Thus, both multiples were recorded at their peaks in the history of CREDI. Although the increase in debt to cash flow multiple has been modest compared to the corresponding equity multiple, the Swedish Financial Supervisory report Stability in the Financial System (2019:1) concludes that more capital is needed for banks' lending to commercial real estate companies. 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 capitalization in relation to NOI



Note. Property companies on Nasdaq Stockholm Main Market.

Bonds

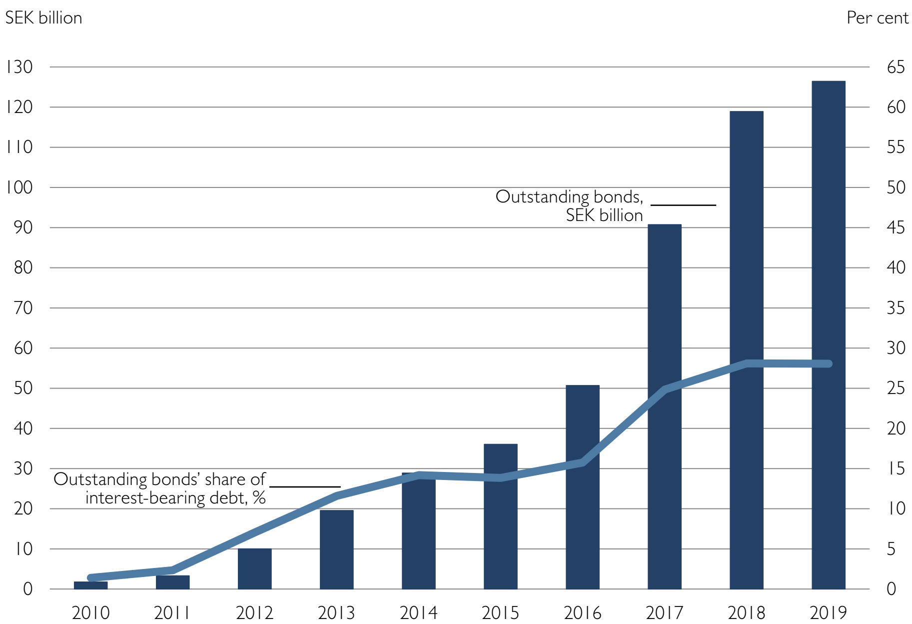
The volume of outstanding corporate bonds continues to grow, but its share of interest-bearing debt has stagnated at around 28 per cent.

In the first quarter of 2019, the market for property-related corporate bonds has been relatively inactive, with existing growth being attributable to a few albeit large issuances. Most notably, Sagax issued a non-secured bond on the European bond market amounting to EUR 300 million. Other active participants on the bond market include Castellum, Balder, Klövern and Fastpartner.

During the first quarter, the volume of outstanding corporate bonds issued by companies listed on Nasdaq Stockholm Main Market increased by 6.3 per cent from SEK 118.9 billion to 126.4 billion. As such, corporate bonds remain popular with the outstanding volume increasing 29 per cent for the trailing twelve months.

Nevertheless, there are indications of a slow-down in outstanding bond volume growth for property companies, as corporate bonds' share of interest-bearing debt remains at 28 per cent for the third consecutive quarter.

Outstanding bonds

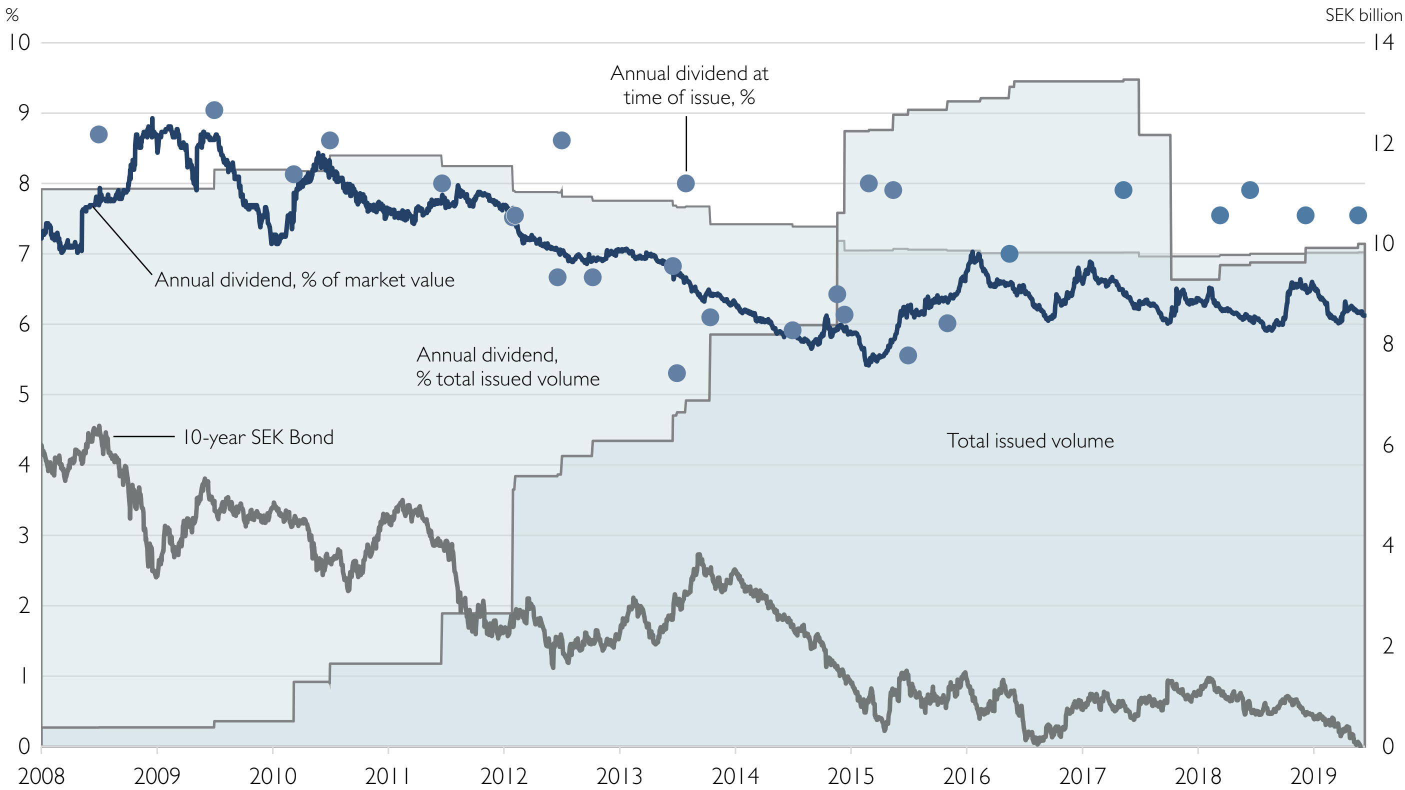


Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The secondary market for property-related preference shares has shown strength in recent months with the average dividend remaining at 6.1 per cent, and there has been some activity on the primary market.

Property companies' preference shares on Nasdaq Stockholm Main Market



In the first quarter of 2019, the secondary market for property-related preference shares ricochet from the previous downturn in the last quarter of 2018. During this time the average dividend shifted from 6.6 per cent to 6.1 per cent. Since then, the average dividend has pendulated between 6.0 and 6.3 per cent, ending up at 6.1 per cent in 1 July 2019. As such, the market for property-related preference shares has shown stability in an otherwise volatile stock market environment.

However, the turbulence on the Swedish housing market has now reached the market for property-related preference shares. More specifically, the dividend for the preference shares issued by Oscar Properties has been put on hold in an effort to strengthen the financial position of the company. A hasty slowdown in sales of newly constructed condominiums has severely impacted cash flows. As such, Oscar Properties' preference shares are trading at extreme volatility with normal dividend yields varying between 10 to 50 per cent.

At the same time, the cash flow focused property company NP3 has been active on the primary market, issuing 3.1 million preference shares, amounting to SEK 101.8 million, in order to create financial flexibility to capitalize on current acquisition opportunities.

However, the previously recognized trend where property companies have sought alternatives to preference shares in order to improve their credit rating has continued. In May, Sagax issued an additional 5.9 million high-yielding class D common shares. Following the same trend, Samhällsbyggnadsbolaget i Norden has issued two rounds of their high-yielding class D common share for a total amount of approximately SEK 885 million. The credit rating optimization of capital structures continues as credit ratings become increasingly important.

Catella's view through the looking glass

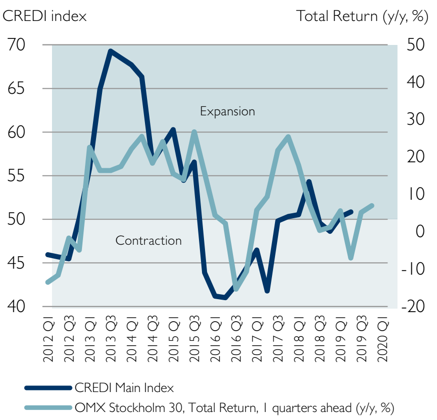
The equity market has rebound strongly this year, with the total return of the OMX 30 index being nearly 20 per cent. The main driver has been the U-turns of the major central banks and the expectation that we will see lower interest rates and more quantitative easing from the central banks going forward.

The Swedish equity market is a reasonably good leading indicator of the CREDI Main index, and its development suggests that we will see stable credit sentiments during the coming quarters. The CREDI index is also a good leading indicator of the banks' lending to the property sector, which in turn goes hand in hand with the transaction volume on the property market. Lower underlying market interest rates and good access to affordable credit for the major property investors are factors that have benefitted the Swedish property market and that have contributed to a strong first half of the transaction year.

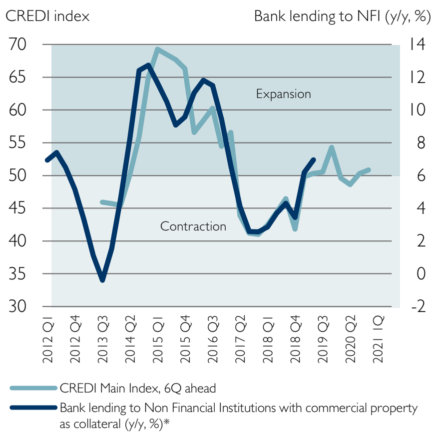
The bond market clearly indicates slower global growth going forward. The Swedish 10-year government bond was in negative territory until mid-June and Swedish and German 10-year bond yields have lately eclipsed their 2016 nadirs. An important gauge of the global economy is the yield difference between short and long-dated US government bonds. The yield difference between 3-month US government bills and the 10-year bond has gone significantly into negative territory since mid-May, and is now below -0.10. The yield difference between short and long-term bills and bonds has been a reliable indicator of every upcoming US economic recession since the late 1960s. Although it is premature to say that we are heading into a full-scale global recession, global growth is declining.

Listed Swedish property companies have performed much better that the broad equity market in the past month, with a positive total return for the ten largest listed companies of over 30 per cent year-to-date. Since these companies have a fixed interest term of around three years on average, changes in the underlying market interest rates and interest margins are rolling through the companies' expenses slowly. The average interest rate costs of Swedish property companies will likely continue to decline gradually in the next 12–18 months, which will continue to push down prime property yields in major and regional cities. However, both Swedish and foreign investors are selective and are prioritizing commercial properties in the three main cities.

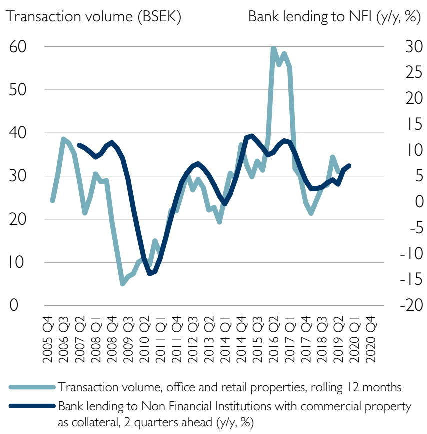
CREDI Current Situation and OMX Sthlm 30



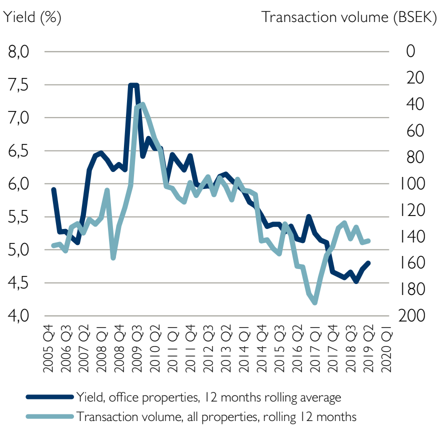
CREDI Current Situation and bank lending



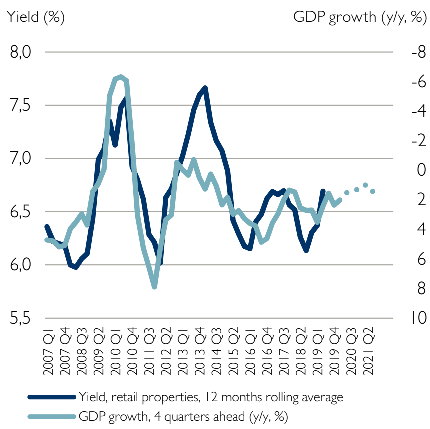
Transaction volume and bank lending



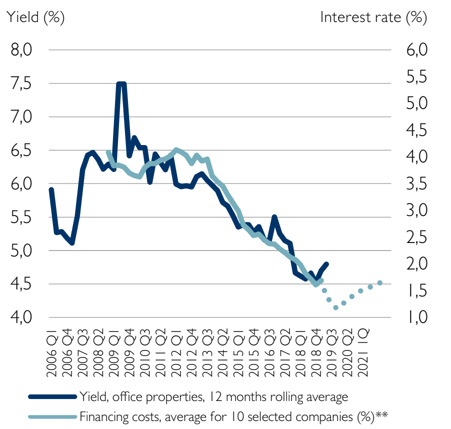
Average office yields* and transaction volume



Average retail yields* and GDP growth



Average office yields* and average financing costs**



Source: FactSet and Catella

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

** Average financing costs for Atrium Ljungberg, Castellum, Diös, Fabege, Fastpartner, Hufvudstaden, Kungsleden, Klövern, Wallenstam and Wihlborgs.

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