CATELLA

CREDI®

CATELLA REAL ESTATE DEBT INDICATOR

CREDI October 2019

Property companies enters new territory as policy turns dovish

In the October issue of CREDI, the Main index increases from 50.8 to 56.3 indicating a substantially improved credit market. Property companies maintain an even stronger view of the credit market while banks improve their view of the future.

CREDI SURVEY REFLECTS A STRONG CREDIT MARKET

In the October survey respondents say access to credit has improved substantially, while credit margins have decreased further. Consequently, the credit market is in a solid place.

PROPERTY COMPANIES SEE THE STRONGEST CREDIT MARKET IN MORE THAN THREE YEARS

The CREDI Main index for property companies increases from 56.9 to 64.9, driven by a considerable surge from 57.5 to 72.0 in the most recent Current Situation index.

POST-QUARTER DOVISHNESS IMPACTS THE CREDIT MARKET

The CREDI indices for the second quarter of 2019 suggest a rather uneventful three months. However, pivotal post-quarter developments within monetary policy have influenced the credit market.

STOCK MARKET MAPS OUT NEW TERRITORY

The Federal Reserve's monetary policy spurred the markets and property-related shares skyrocketed to nearly SEK 540 billion in aggregated market capitalisation.

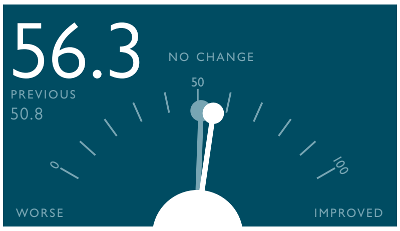
ACTIVITY PICK-UPS IN THE MARKET FOR PROPERTY-RELATED BONDS

Although the second quarter experienced no major issue, activity has been rather high with several smaller issuances and Nyfosa debuting with their first bond on the market amounting to SEK 750 million.

MARKET FOR PREFERENCE SHARES SHOWS STRENGTH

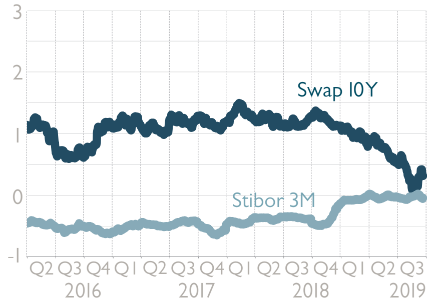
Property-related preference shares have shown stability in the second quarter of 2019. Following the post-quarter developments within monetary policy, yield compression sees the average dividend decreasing to 5.8 per cent.

CREDI Main index



Banks	Corporates
47.7	64.9
44.8	56.9

Swedish key interest rates, 2016–2019. Per cent



Loan-to-value Q2 average ↘ 53%	Interest rate Q2 average → 2.0%	Fixed credit term Q2 average ↘ 3.5 y	Fixed interest term Q2 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

The CREDI Main index increases from 50.8 to 56.3, suggesting a considerably improved credit market in the October survey. While both the Current Situation index and the Expectation index improve, banks and corporates show increasingly divided opinions in both indices.

Main index components

In the October survey of CREDI, the Main index increases from 50.8 to 56.3, continuing the trend where the CREDI survey indicate a improved credit market. The CREDI survey suggests that the credit market remains stable considering the index exceeds the 50-mark.

Continuing on the previous trend, respondents have a positive view of the current situation of the credit market while banks have a less positive view of its future development. In the October survey, the Current Situation index increases from 55.8 to 61.8 while the Expectation index also increases from 45.8 to 50.8. Remarkably, this is the first time in nearly four years that the Expectation index surpasses the 50-mark. The shift indicates not only that the credit market can be considered stable, but also that it has a positive outlook.

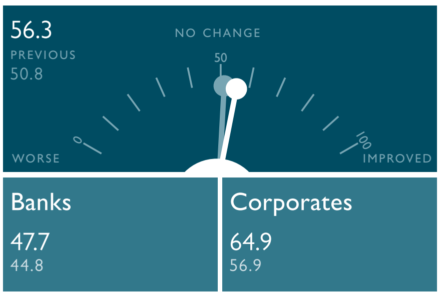
While the banks' Current Situation index decreases from 54.2 to 51.6 and their Expectation index increases from 35.4 to 43.8, property companies' Current Situation index increases substantially from 57.5 to 72.0 and their Expectation index increases marginally from 56.3 to 57.8.

Consequently, banks are still rather pessimistic with their Main index just below the 50-mark while property companies are increasingly optimistic and expect to continue to reap benefits from the credit market. Notably, the property companies' Main index at 64.9 is the highest mark for more than three years.

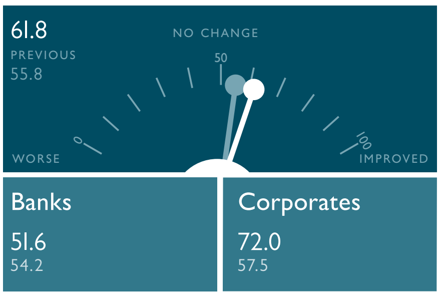
Sub-indices

The CREDI Main index is made up of eight underlying sub-indices. In the October survey, the Current Situation index was improved by increased credit availability, reduced credit margins and extended credit durations, while leverage seems to have remained unchanged. With regard to the Expectation index, credit duration is expected to increase while leverage and credit availability remain unchanged. At the same time, the Expectation index is affected by a negative view on credit margins.

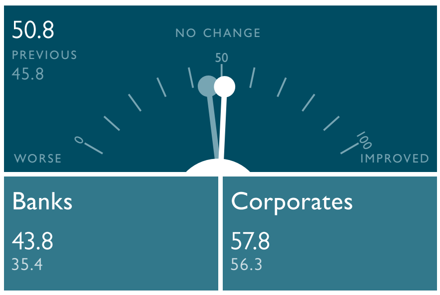
CREDI Main index



Current Situation



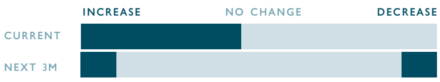
Expectation



CREDI sub-indices

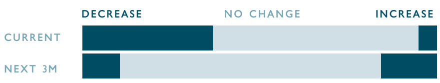
The CREDI sub-indices present survey data question by question. The bars represent the distribution of actual answers per question, separated into the components Current Situation and Expectation for the coming three months.

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.

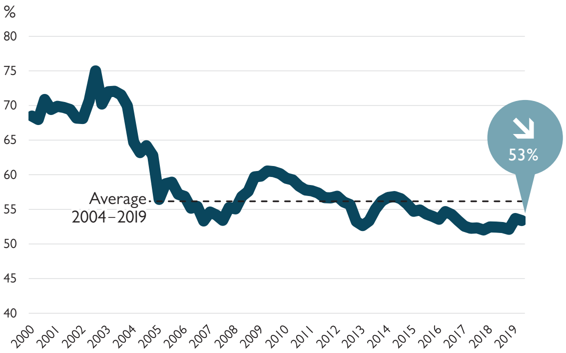
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 second quarter of 2019 indicate that property companies have seen a fairly stable and uneventful credit market. However, post-quarter developments may have had significant impact on all of the CREDI indices.

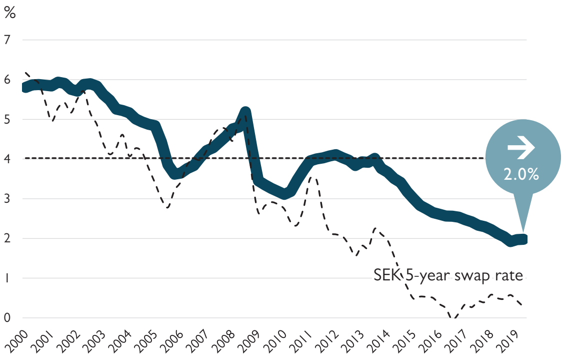
Listed sector Q2 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market reverts from 54 to 53 per cent due to a proportionally larger increase in property values compared to the underlying changes in debt levels. Nevertheless, the current level still remains below the historical average of 56 per cent.

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

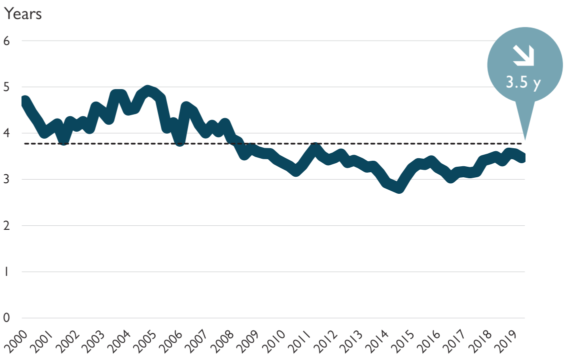
Listed sector Q2 average interest rate[2]



The average interest rate of listed property companies remained at 2.0 per cent in the second quarter of 2019. Given the developments within monetary policy after the second quarter, historically low interest rates may become even lower going forward. Hufvudstaden, Wallenstam and Diös all have industry-leading average interest rates of 1.2 per cent.

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

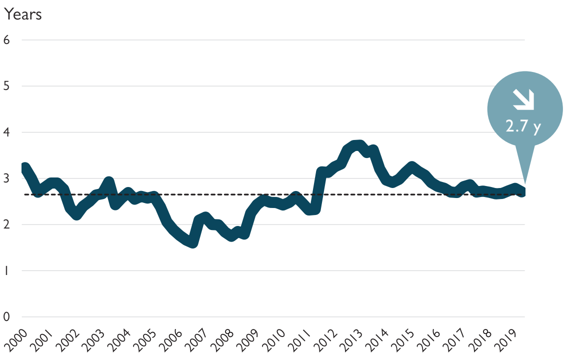
Listed sector Q2 average fixed credit term[3]



The average fixed credit term among listed property companies decreased slightly to 3.5 years in the second quarter of 2019, below the long-term average of 3.8 years. No clear trend could be identified during the quarter, which seems to be a theme attributable to the markets waiting for a more coherent monetary policy to be communicated.

3 Average maturity referring to interest-bearing debt.

Listed sector Q2 average fixed interest term[4]



-------- Average 2000–2019

The average fixed interest term among listed property companies decreased from 2.8 to 2.7 years, which makes the current term equivalent with the long-term average of 2.7 years. The effect from the more recent developments on the debt markets with decreasing long-term interest rates (which caused an inverted yield curve on several maturities) has not yet materialised during the second quarter, but will be analyzed in future editions of CREDI.

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.

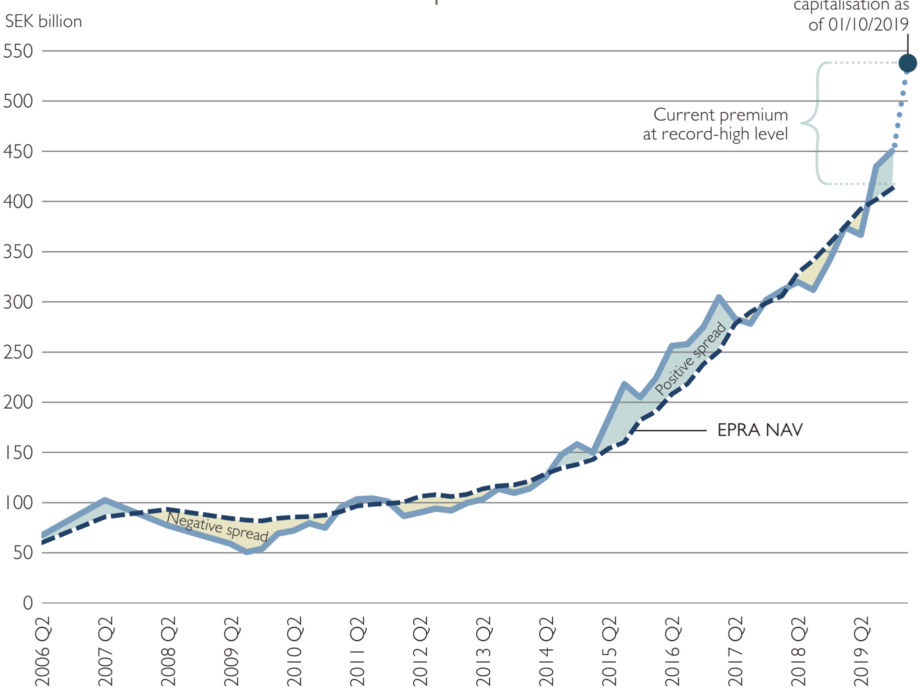
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

In the second quarter of 2019 the listed shares of property companies on the Nasdaq Stockholm Main Market remained fairly unchanged due to an uncertain Federal Reserve. However, as the Fed's policy turned dovish, the market responded as shares appear to be trading at a record-premium of around 30 per cent.

The market capitalisation of the listed shares of property companies on the Nasdaq Stockholm Main Market remained rather stable during the second quarter due to uncertainties regarding the Federal Reserve's monetary policy. As macro-economic indicators shift toward a more negative outlook illustrated by an inverted yield curve together with increased trade-war tensions between the US and China, and an increasingly resounding president, the Federal Reserve has responded with two subsequent interest rate cuts; the first cuts to occur since the last financial crisis. Market capitalisation increased from SEK 444 billion to SEK 450 billion, while the property companies' EPRA NAV increased slightly from SEK 411 billion to SEK 413 billion, resulting in a premium of 9 per cent in the end of the second quarter. As of 01/10/2019, the premium appears to have reached record-levels with an aggregated market capitalisation of SEK 538 billion.

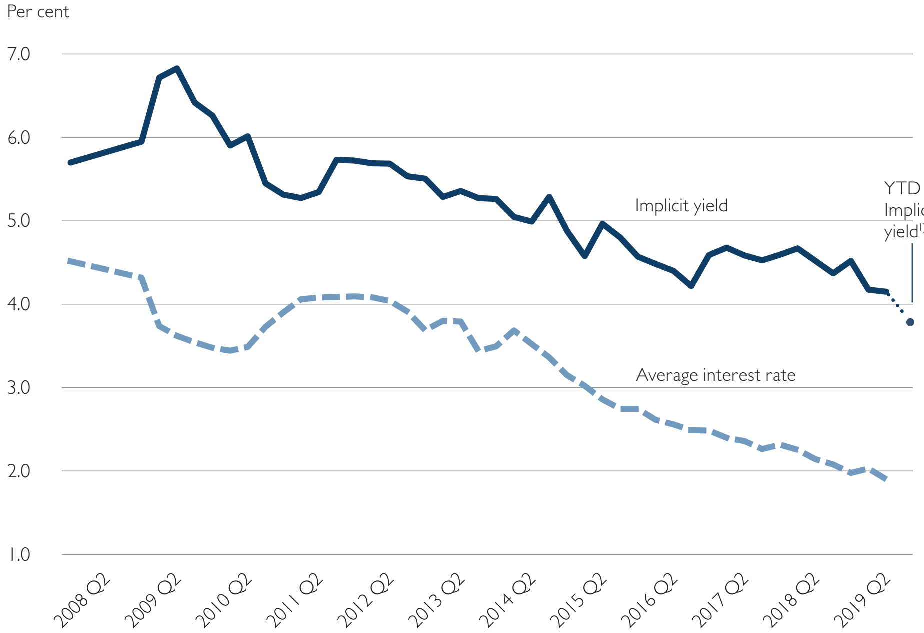
Premium or discount – market capitalisation and EPRA NAV



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 second quarter of 2019, the implicit yield of listed property companies remained at 4.2 per cent. The spread between listed property companies' implicit yield and their average interest rate is approximately 2.3 per cent, which is higher than the previous quarter's 2.2 per cent, and thus the historically wide spread remains. Moving forward, the year-to-date implicit yield has decreased to 3.8 per cent as of 01/10/2019, a result of the stock markets' strong performance. The price surge accredited to the shift in monetary policy seems to withstand any global political uncertainties, of which there are quite a few, thus putting the importance and influence of the Federal Reserve into perspective.

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



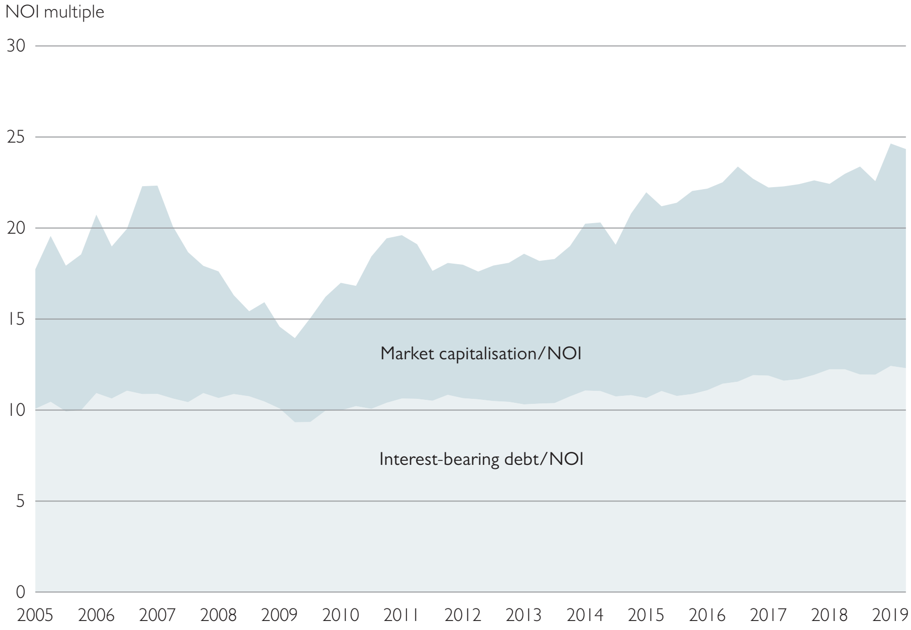
[1] Market values 01/10/2019 and 2019 Q2 EPRA NAV.

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 12.4 to 12.3 times net operating income in the second quarter of 2019, while market capitalisation decreased from 12.2 to 12.0 times net operating income. In recent years, the credit market has adjusted its lending in almost 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. Nevertheless, property value remained rather unchanged during the quarter while the aggregated net operating income grew by nearly 10 per cent. 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

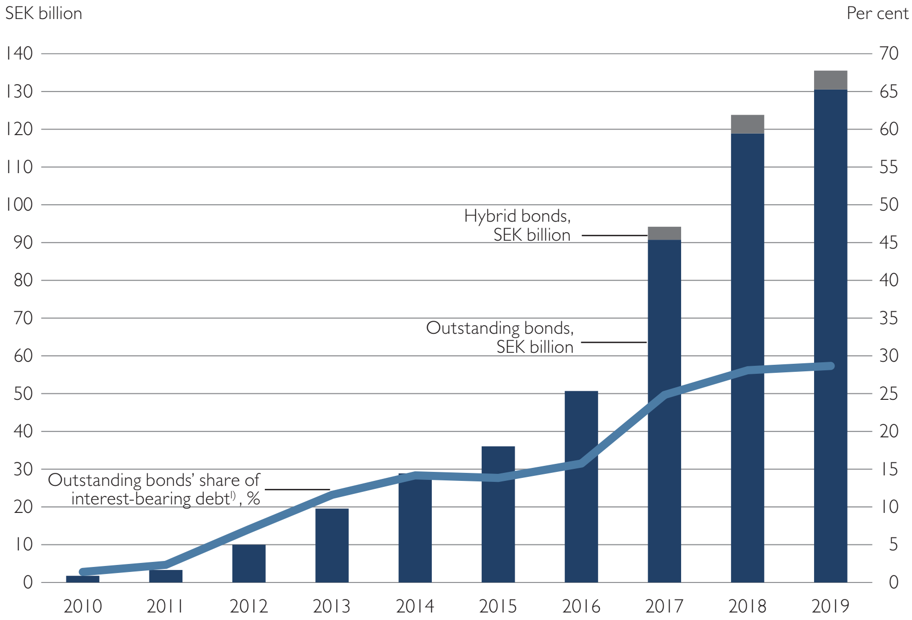
Growth in volume of outstanding property-related corporate bonds has slowed down while its share of interest-bearing debt increased to almost 29 per cent.

In the second quarter of 2019, the market for property-related corporate bonds has been relatively active. Deviating from the previous trend of larger issuances, the second quarter displayed no major issue with Castellum being the only market participant increasing its net exposure by more than SEK 1 billion. Other active participants with increased net exposure of more than SEK 500 million included Atrium Ljungberg, Hemfosa, Klövern and lastly Nyfosa, which issued its first bond amounting to SEK 750 million.

During the second quarter, the volume of outstanding corporate bonds, excluding hybrid bonds classified as equity, increased by 3.3 per cent from SEK 126.4 billion to 130.5 billion.

Even though the second quarter growth in outstanding volume of property-related bonds is modest, interest remains as indicated by an increased spread between growth in more traditional debt financing and corporate bonds.

Outstanding bonds



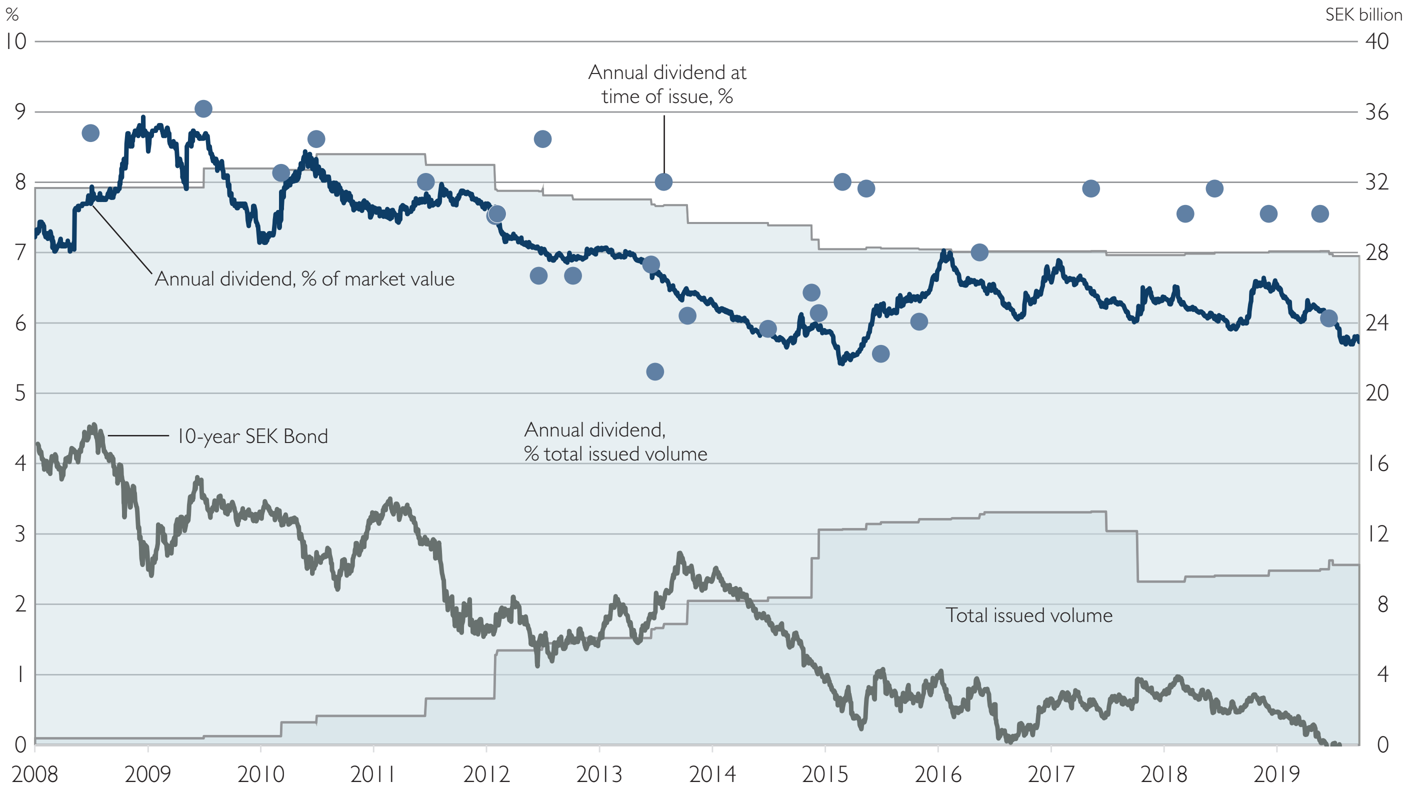
[1] Excluding hybrid bonds classified as equity.

Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The secondary market for property-related preference shares has shown strength following the interest rate developments in recent months, with the average dividend decreasing to 5.8 per cent.

Property companies' preference shares on Nasdaq Stockholm Main Market



In the second quarter of 2019, the secondary market for property-related preference shares remained rather unchanged. During this time the average dividend pendulated between 6.0 and 6.3 per cent, ending up at 6.1 per cent at the end of the quarter. Since then, the secondary market for property-related preference shares has developed strongly with the average dividend decreasing to 5.8 per cent. The underlying market factors remain the same as with the price surge for property-related common shares, further visualising the precedence that monetary policy currently holds over the Swedish market.

The turbulence on the Swedish market for newly constructed apartments has continued to induce volatility on the market for property-related preference shares. More specific, the dividend for the preference shares issued by Oscar Properties is still on hold as efforts to strengthen the company's financial position continue. A hasty slowdown in forward-sales of newly constructed condominiums has severely impacted cash flows where the current market sentiment requires property developers to strengthen their balance sheets as banks are not willing to absorb the elevated risk of unsold units. Measures such as partnering up with financially strong counterparties illustrate the difficulties that smaller and less capitalised developers stand to face going forward. Even though some of these measures have been successful, a lot of uncertainty remains. Accordingly, the Oscar Properties preference shares are still trading at extreme volatility with normal dividend yields varying between 10 per cent and 50 per cent.

The previously recognized trend where property companies have sought alternatives to preference shares in order to improve their credit rating has continued. Akelius Residential Property is currently issuing class D common shares at a minimum of EUR 192.5 million and a maximum of EUR 407 million. The credit rating optimisation of capital structures continues as credit ratings become increasingly important to property companies.

Catella's view through the looking glass

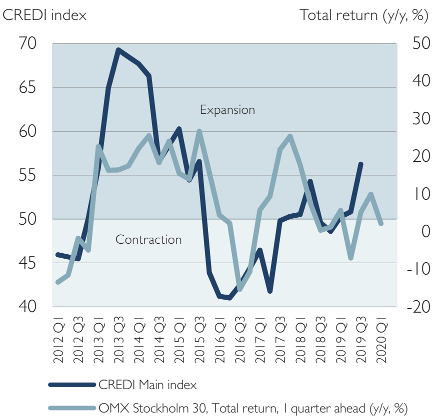
The Swedish equity market is a good leading indicator of the CREDI Main index and indicates stable credit sentiments during the coming quarters. The CREDI index is also a good leading indicator of the banks' lending to the property sector, which in turn goes hand in hand with the transaction volume on the property market.

Transaction volumes have been historically high and stable on the Swedish property market during recent years. However, there has been a clear shift towards fewer but larger deals during the recent 6–12 months. During almost all months since the mid-2000s, the number of transactions has been in the interval 330 and 420 deals per year. In fact, this interval has only been breached three times during the last 15 years. The first time was in connection to the financial crisis, when the figure fell to 190 transactions per year. The second time was 2013–2014 when the number fell just below 280 transactions per year, and the third time is currently ongoing and started this summer. Over the last 12 months the number of transactions has dropped from 410 to about 300 deals per year.

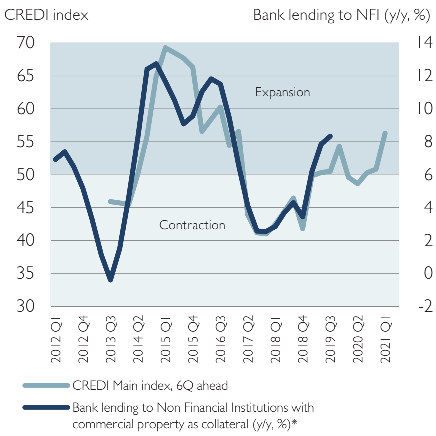
In addition, the average transaction volume per deal has also been stable during the last 15 years. The average volume per transaction has only deviated from its stable long-term trend on three occasions since the mid-2000s. In every circumstance, the number of transactions fell below the lower interval of 330 deals per year a few months to a year prior (the occasions mentioned above). Since January 2015, the average volume per transaction has fluctuated around SEK 400 million. In August and September 2019, however, the average deal size soared to SEK 500 million. Notably, also this time the increase followed a previous drop in the number of transactions below 330 deals per year in June.

It seems like one of the first signs of a trend-shift on the property market is that the number of transactions drops before a noticeable effect on the average transaction volume is registered. The last six months of declining inteterst rates may have started a rotation of investors, as some traditional buyers are seeing the market as too expensive while new investors with lower yield requirements are entering the market. In this process, the number of deals are declining while the average size of the deals increase as many new investors are focusing on building volume fast.

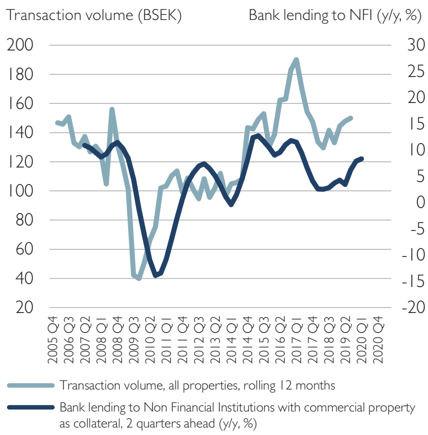
CREDI Main index and OMX Sthlm 30



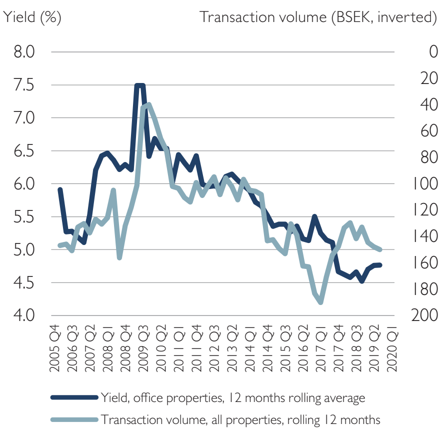
CREDI Main index and bank lending



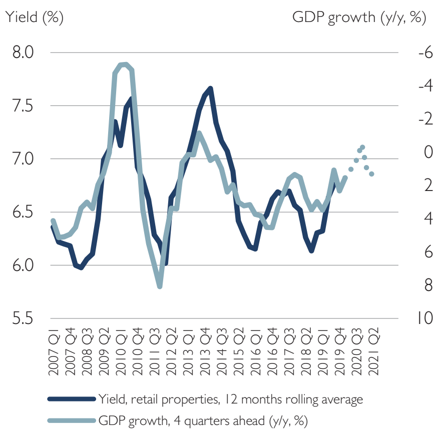
Transaction volume and bank lending



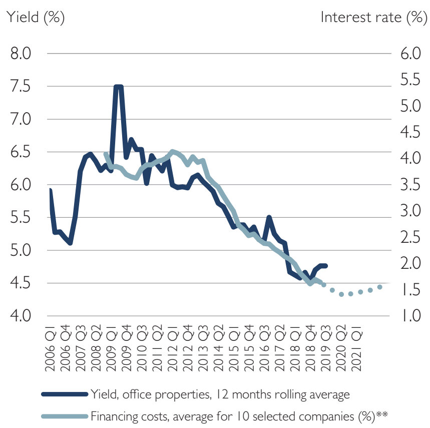
Average office yields* and transaction volume



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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CATELLA

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