CREDI December 2019

Credit market sentiment stabilises but property equities outperform

In the December issue of CREDI, the Main index decreases from 56.3 to 49.5 indicating a slightly weakened credit market. Meanwhile, market capitalisation for the listed property companies soars as premium exceeds 30 per cent.

CREDI SURVEY REFLECTS A SLIGHTLY WEAKENED CREDIT MARKET

The December survey shows a slightly weakened credit market compared to the October survey as banks and corporates expect expanded credit margins going forward.

PROPERTY COMPANIES MAINTAIN A POSITIVE VIEW

The CREDI Main index for property companies decreases from 64.9 to 56.0 as the Current Situation index weakens considerably from 72.0 to 57.6 and there is a minor reversion from 57.8 to 54.4 in the Expectations index.

CREDI INDICES INDICATE LONGER FIXED INTEREST TERMS

Average interest rate remains rather unchanged as average fixed interest term increases when property companies respond to low long-term market interest rates.

DURABLE LOW INTEREST RATES INCITE EQUITY MARKET PREMIUMS

Market capitalisation suggests a historically high premium of over 30 per cent in aggregate as equity market adapt to low long-term interest rates and M&A activity picks up.

EQUITY MARKET ACTIVITY SPILLS OVER ON DEBT MARKETS

There is major activity within the bond markets as SBB boosts their balance sheet in preparations for Hemfosa acquisition. In addition, Castellum and Balder are increasing their bond market presence.

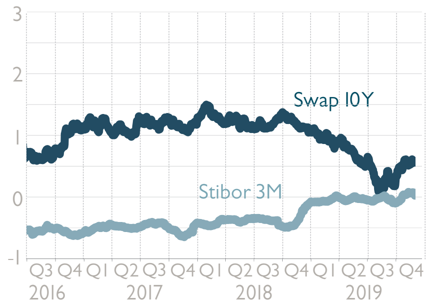
DIVIDEND YIELDS FOR PREFERENCE SHARES BOTTOMS OUT

The average dividend yield for property-related preference shares have bottomed out at 5.7 per cent. Issuers' continue to favour class D common shares or equity hybrid bonds.

CREDI Main index

Banks	Corporates
43.0	56.0
47.7	64.9

Swedish key interest rates, 2016–2019. Per cent



Loan-to-value Q3 average	Interest rate Q3 average	Fixed credit term Q3 average	Fixed interest term Q3 average
↘ 52%	→ 2.0%	→ 3.5 y	↗ 3.1 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 declines from 56.3 to 49.5 as both banks and corporates adjust their views of the credit market and thus marking the end of a yearlong improvement to the index. Respondents' see a positive current credit market while they have turned slightly more pessimistic going forward.

Main index components

Over the past 12 months, the CREDI Main index has steadily improved going from 48.6 in December 2018 to 56.3 in September 2019. This trend of an increasing Main index came to a halt with the December survey as the Main index fell by a hefty 6.8 points. This marks the biggest quarterly drop in the Main index since the survey conducted in December 2015.

The development of the Main index is driven by both a drop in the Current Situation index as well as a drop in the Expectations index. Respondents consider the Current Situation continuously positive but well below what it was in September 2019, as the index drops from 61.8 to 53.0. At the same time, the Expectations index declines from 50.8 to 45.9. In aggregate, the CREDI survey indicates that respondents see the current credit market as stable but expect a slightly deterioating development going forward.

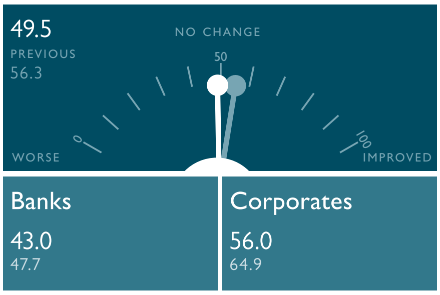
While the banks' Current Situation index decline from 51.6 to 48.4 and their Expectation index decline from 43.8 to 37.5, corporates' move in the same trajectory, as their Current Situation index decreases from 72.0 to 57.6 and their Expectation index drops from 57.8 to 54.4.

As has been the case for several years, banks and corporates continue to display divided opinions on the state of the credit market as corporates tend to have a more positive view of the credit market, while banks are generally more negative. However, both banks and corporates in the CREDI survey of December 2019 alternated unanimously in both index components.

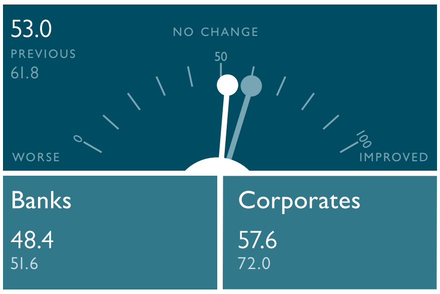
Sub-indices

The CREDI Main index is made up of eight underlying sub-indices. In the December survey, the Current Situation index was improved by increased credit availability, reduced credit margins and extended credit durations, while leverage decreased marginally. With regard to the Expectation index, credit availability, leverage and duration remain rather unchanged. Instead, the Expectation index faced headwinds as respondents' believe that credit margins are expected to increase going forward.

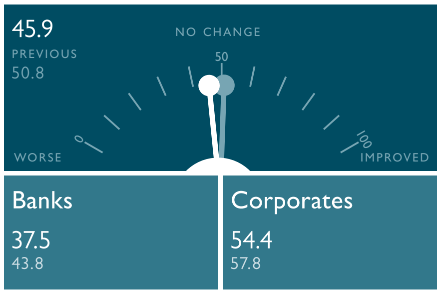
CREDI Main index



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.

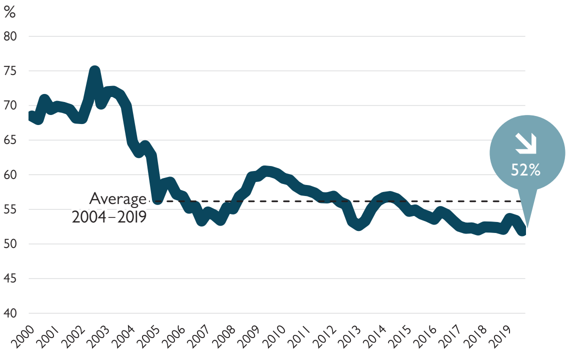
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 third quarter of 2019 show that property companies respond to the developments on the debt markets with attractive rates on long-term financing.

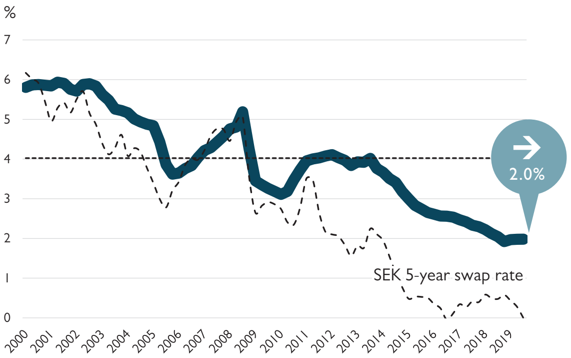
Listed sector Q3 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market decreased slightly to 52 per cent due to a proportionally larger increase in property values compared to the underlying changes in debt levels. As such, the current level continues to remain below the historical average of 56 per cent.

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

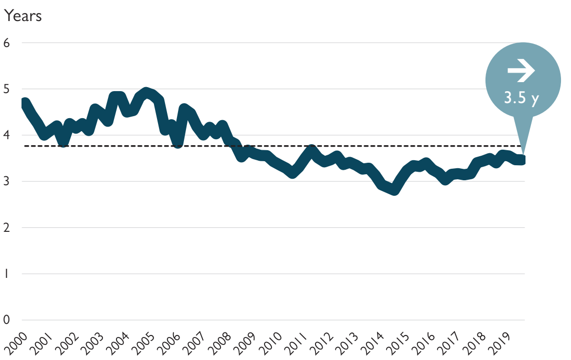
Listed sector Q3 average interest rate[2]



The average interest rate of listed property companies remained at 2.0 per cent in the third quarter of 2019. Currently, Hufvudstaden, Wallenstam and Diös all have industry-leading average interest rates of 1.2 per cent while Corem increased their average interest rate from 3.1 to 3.8 per cent. Although not stated, the change probably has to do with underlying changes within Corem's portfolio as they divested properties to Blackstone for SEK 4.2 billion.

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

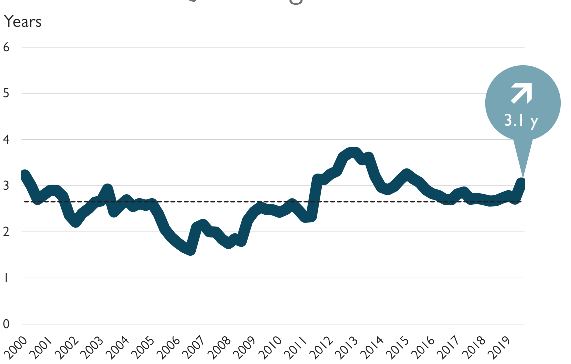
Listed sector Q3 average fixed credit term[3]



The average fixed credit term among listed property companies remained at 3.5 years in the third quarter of 2019, slightly below the long-term average of 3.8 years. During the quarter no clear trend could be identified as most companies' fixed credit terms where shortened slightly, while fixed credit terms for active participants on the bond markets increased.

3 Average maturity referring to interest-bearing debt.

Listed sector Q3 average fixed interest term[4]



-------- Average 2000–2019

The average fixed interest term among listed property companies increased significantly from 2.7 to 3.1 years which makes the current term above the long-term average of 2.7 years. The effects from the developments on the debt markets with low long-term market interest rates are now starting to materialise where property companies see long-term financing as increasingly attractive.

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.

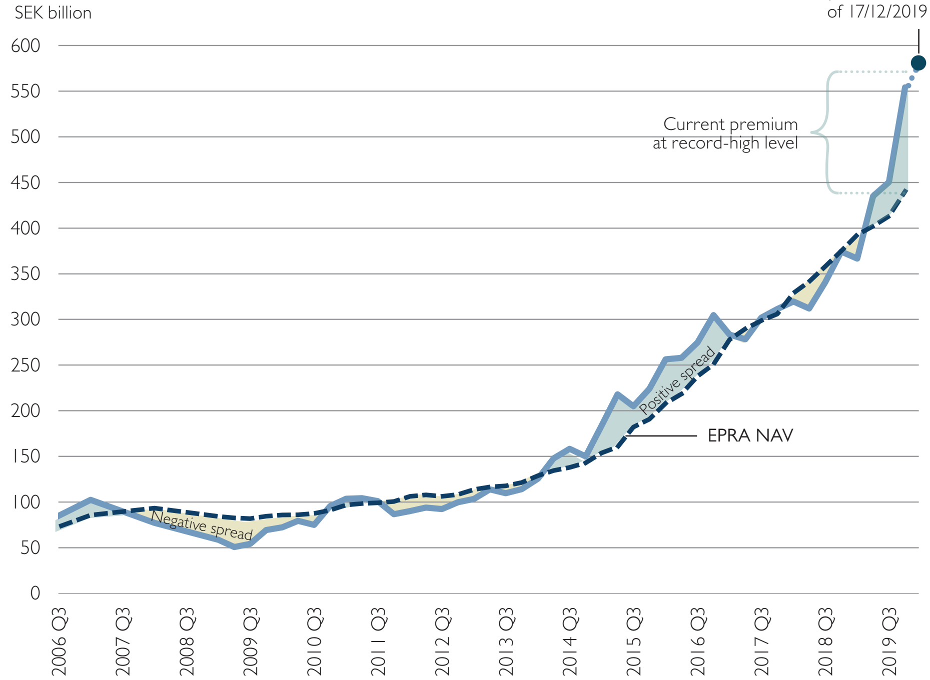
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

In the third quarter of 2019 the market capitalisation of property companies on the Nasdaq Stockholm Main market expanded into new territory as implicit yields fell below 4 per cent. This has resulted in an average premium on EPRA NAV of over 30 per cent.

During the third quarter of 2019 the market capitalisation of the property-related listed shares on the Nasdaq Stockholm Main Market spiked as a result of the declining long-term interest rates up until the early autumn. Investors now expect the low interest rate levels to remain in the foreseeable future. As such, the market capitalisation increased from SEK 450 billion to SEK 554 billion, while the property companies' EPRA NAV increased from SEK 413 billion to SEK 440 billion. As of 17/12/2019, the premium appears to have increased further as market capitalisation increased to SEK 581 billion, suggesting a premium of around 32 per cent.

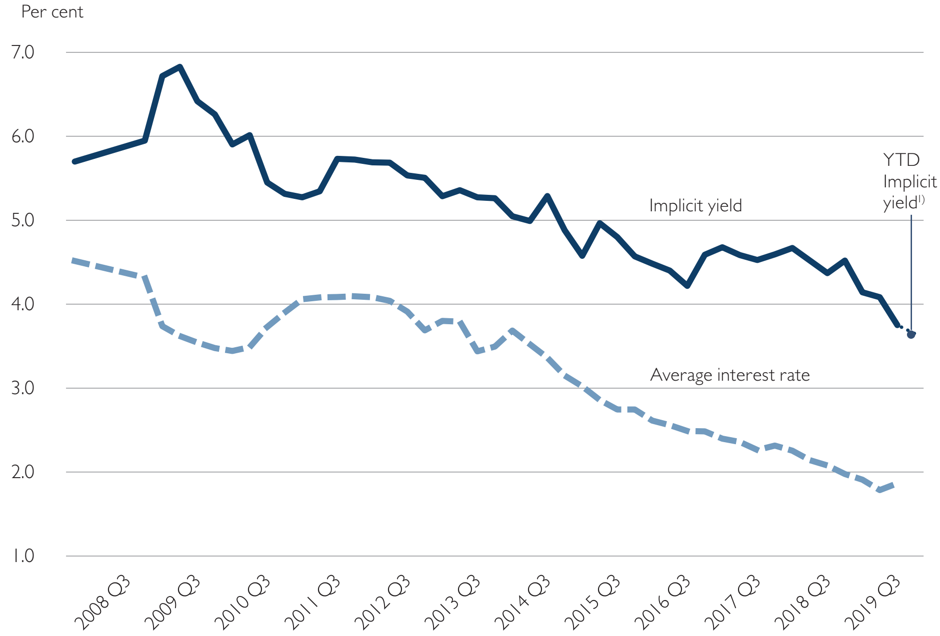
Premium or discount – market capitalisation and EPRA NAV



Note. Property companies on Nasdaq Stockholm Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, corresponding to 5.5 per cent when considering the tax rate before 2019.

The implicit yield of the listed property companies entered new territory by falling below 4 per cent to 3.8 per cent in the end of the third quarter. The spread between listed property companies implicit yield and their average interest rate is approximately 1.9 per cent, which is lower than the previous quarter's 2.3 per cent as the average interest rate has increased while implicit yields declined. Moving forward, the year-to-date implicit yield has descended further to 3.7 per cent as of 17/12/2019, a result of the strong performance on the stock market. The stock market continues to be stable even though the interim reports of the third quarter illustrated some downsides of the weakening economy where a number of reported negative net lettings.

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



[1] Market values 17/12/2019 and 2019 Q3 EPRA NAV.

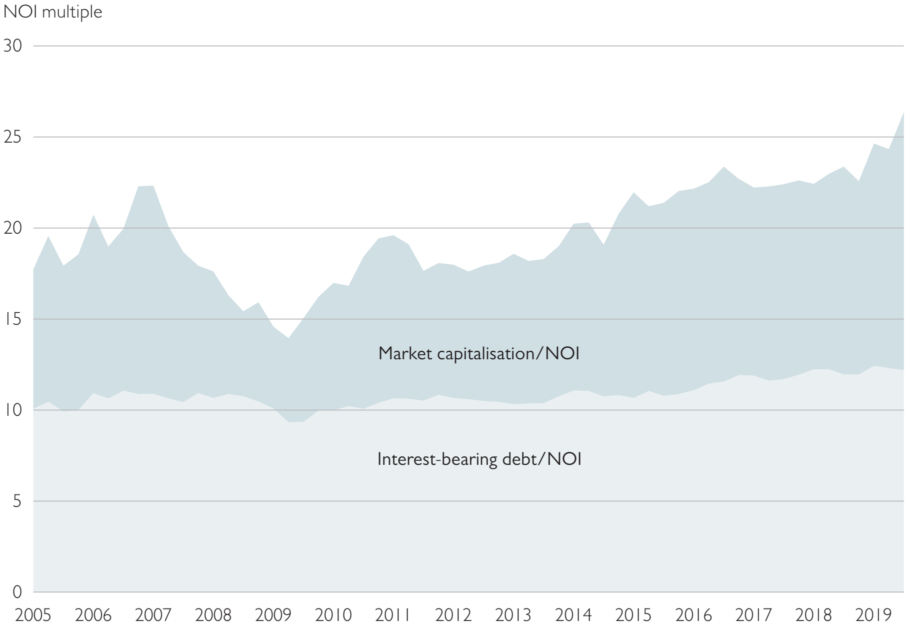
Note. Property companies on Nasdaq Stockholm Main Market. Average interest rate is weighted by using the EPRA NAV to Book value of properties ratio. EPRA NAV includes a 25 per cent deduction for deferred tax, corresponding to 5.5 per cent when considering the tax rate before 2019.

Source: Catella, annual reports, Nasdaq.

Interest-bearing debt decreased slightly from 12.3 to 12.2 times net operating income in the third quarter of 2019, while market capitalisation surged from 12.0 to 14.2 times net operating income. As such, net operating income has grown with a higher pace than interest-bearing debt while on the other hand, market capitalisation grew even faster. The illustrated multiple expansion shows that investors now value the same net operating income at a higher multiple, principally driven by the interest rate development.

Sweden's financial supervisory authority recently declared that the commercial real estate sector is vulnerable and suggested additional capital requirements to be added for banks' lending to the sector. As such, bank lending to property companies might grow at a slower pace going forward.

Interest-bearing debt and market capitalisation in relation to NOI



Note. Property companies on Nasdaq Stockholm Main Market.

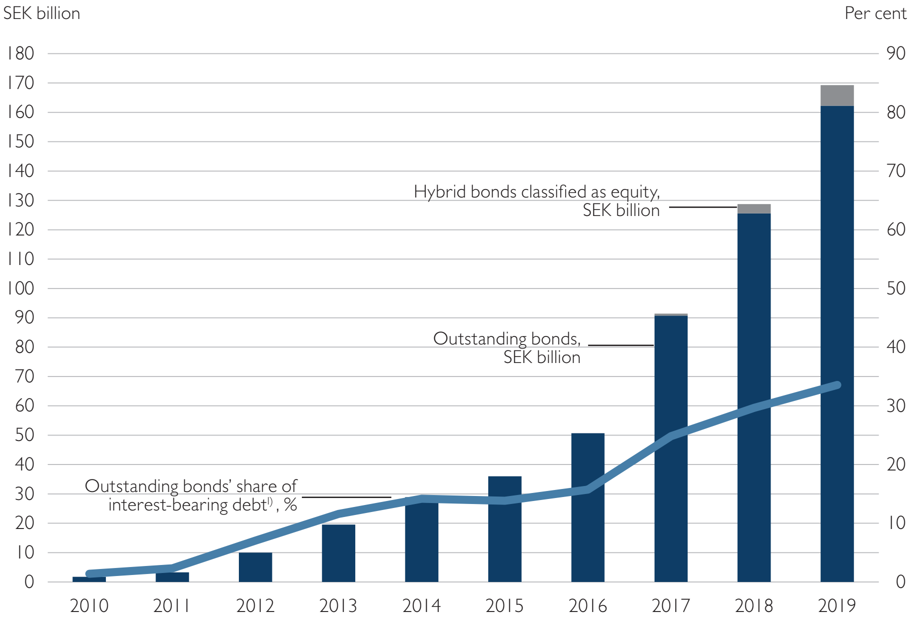
Bonds

M&A activity spur bond issuance as the outstanding bond volume for the companies increases by 15.5 per cent. Thus, corporate bonds now make up around 34 per cent of the listed companies' interest-bearing debt.

The third quarter of 2019 experienced major movement in the market for property-related corporate bonds. Firstly, Castellum's net exposure increased by more than SEK 4 billion due to activity on primarily the Euro bond market but also the Norwegian and Swedish markets. Secondly, Balder has been active on the Euro bond market by issuing a EUR 500 million bond. Last but not least, SBB prepared for the acquisition of Hemfosa by issuing a EUR 500 million bond and a SEK 500 million bond. Since the beginning of the year, SBB's net exposure to corporate bonds has increased by over SEK 11 billion.

During the third quarter, the volume of outstanding corporate bonds issued by companies listed on Nasdaq Stockholm Main Market, excluding hybrid bonds classified as equity, increased by 15.5 per cent from SEK 140.5 billion to 162.3 billion.

Outstanding bonds



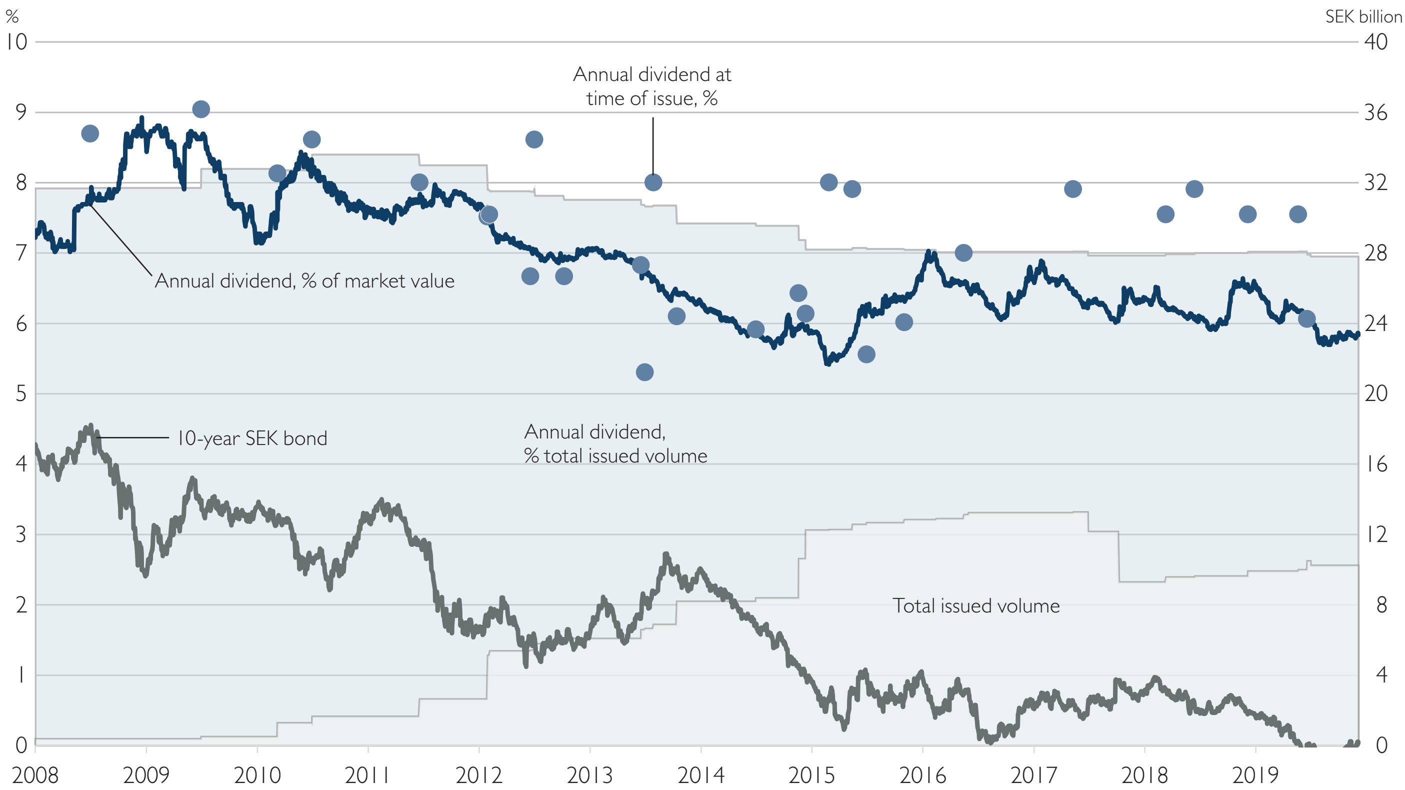
[1] Excluding hybrid bonds classified as equity.

Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The average dividend yield of property-related preference shares reached 5.7 per cent during the third quarter. This is the lowest level recorded since early 2015.

Property companies' preference shares on Nasdaq Stockholm Main Market



In the third quarter of 2019, the average dividend yield in the secondary market for property-related preference shares ended up at 5.8 per cent. Since July, the average dividend yield has stayed below 6.0 per cent, varying between 5.7 and 5.8 per cent until December. Interestingly, the market for property-related preference shares has shown some resistance when comparing to common shares. This might be related to the predetermined redeemable values, which become important when property companies have started to redeem preference shares and opt for alternative financing. As such, any further drops in the average dividend yield are unlikely.

The turbulence on the Swedish market for newly constructed apartments has started to calm down as more and more newly produced apartments get sold while less enter the market. However, the situation for one specific, Oscar Properties, continues to be unclear, as indicated by their preference shares that continue to be traded at dividend yields above 20 per cent with extreme volatility. In response to this, Oscar Properties has submitted an exchange offer where a number of common shares are traded for preference shares, thus eliminating the build-up in preferred dividend debt accumulated by the preference shares.

The previously recognised trend where property companies sought alternatives to preference shares in order to improve their credit rating has continued. Akelius Residential Property has issued class D common shares while delisting their preference shares. Also, Fastpartner recently listed new class D common shares and it will be interesting to follow whether they intend to replace their existing preference shares or keep a mixed financing structure. On another note, hybrid bonds classified as equity are becoming a more and more viable equity financing option for property companies. To conclude, the credit rating optimisation of capital structures continues as credit ratings become increasingly important due to continued interest in financing from bond markets.

Catella's view through the looking glass

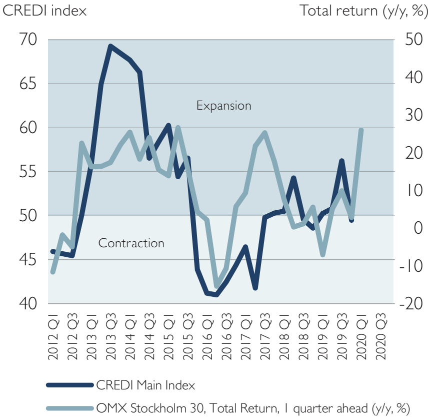
The Swedish equity market is a good leading indicator of the CREDI Main index. Although the CREDI index has fallen back since October, the strong performance on the equity market indicates stable credit sentiments and bank lending to the property sector going forward.

The activity on the Swedish property market has been strong recently and the 12-months rolling transaction volume is around SEK 155 billion in mid-December (up from the full-year-volume of SEK 133 billion in 2018). The trend of fewer but larger deals that has been visible over the recent quarters remain and the 12-months rolling number of transactions is just above 300 deals. The correlation between the average financing costs for the major listed property companies and the average yields of their property portfolios has been almost perfect over the last decade – where 100 basis points lower financing costs has resulted in around 60 basis points lower property yields. As a result, the spreads between financing costs and property yields now stands at historically high levels. It seems like the transaction market is now in the midst of a re-pricing where investors are adjusting to the consensus view of low economic growth and low interest rates for years or decades to come. In this process, the spread between financing costs and property yields is declining and we see a pressure downwards in yield levels.

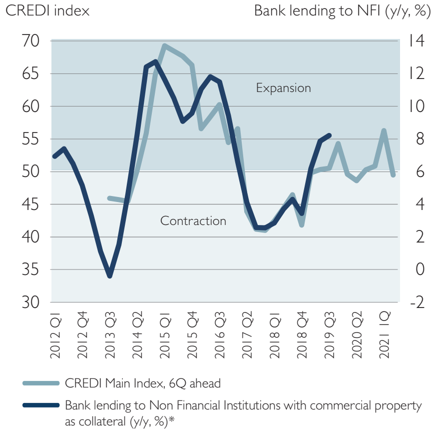
Although the equity price development for the listed property companies has moved sideways since September, the equity total return is still up over 65 per cent year-to-date in average for the Swedish property companies, a result of the interest rate development and positive macro sentiment.

In the long term, it is not unlikely that we are gradually entering a new phase in the global economy with increasing trade barriers, competitive devaluations (currency war), high capacity utilisation in most major economies, increasing political pressure on central banks to accept higher inflation, and more expansive fiscal policies (partly) financed by the central banks. In the medium term, the effect will probably be a pressure upwards on inflation, which will create a more challenging macro environment assets prices in general. However, property may manage this transition better than bonds and equities as it is a real asset with inflation-linked cash flows in most cases.

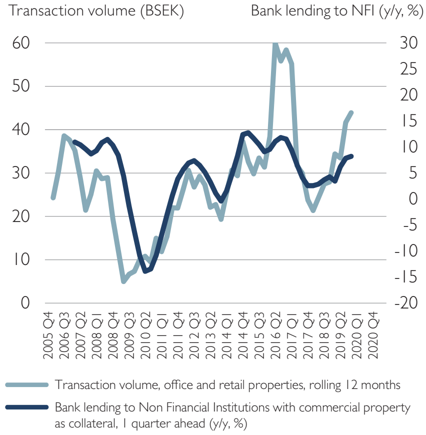
CREDI Main index and OMX Sthlm 30



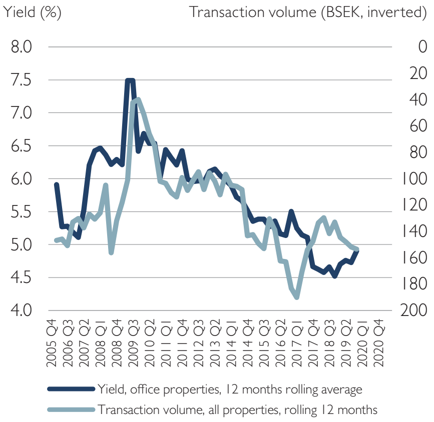
CREDI Main index and bank lending



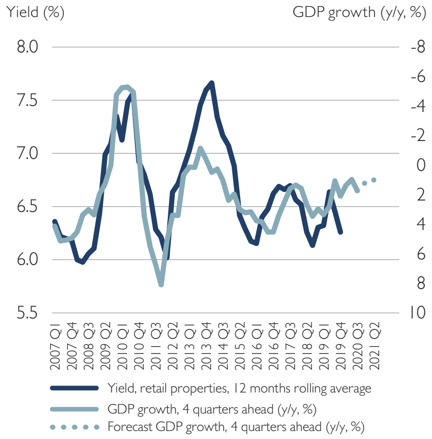
Transaction volume and bank lending



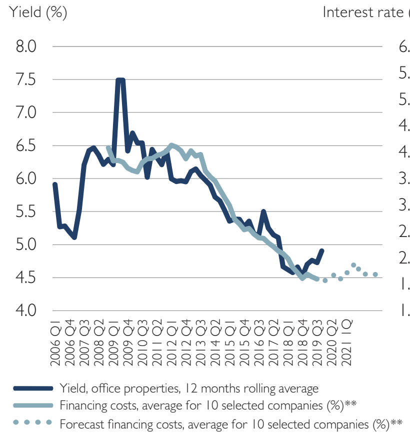
Average office yields* and transaction volume



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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