CREDI April 2020

Investors reprice property equities as credit market risk intensifies

In the April issue of CREDI, the Main index decreases from 49.5 to 33.7 indicating the worst credit market sentiment since the inception of CREDI in 2012. Meanwhile, market capitalisation for property equities decline sharply as investors fear Covid-19 outbreak.

CREDI SURVEY REFLECTS THE LOWEST MAIN INDEX RECORDED

The April survey indicates the most challenging credit market ever recorded in the history of the CREDI survey.

DIVIDED OPINIONS ON THE CREDIT MARKET

While both banks and corporates consider the current situation uncertain, corporates maintain a stable positive outlook while banks are noticeably more pessimistic in their expectations.

REVISED DEBT STRATEGIES TO BE EXPECTED GOING FORWARD

The fourth quarter of 2019 saw only minor changes within the CREDI Indices while recent market development should incite revised debt strategies in the coming quarters.

COVID-19 FEARS SHIFT PREVIOUS RECORD PREMIUM TO DISCOUNT

Investors reprice property equities amidst Covid-19 fears resulting in the previous premium of around 31 per cent shifting to a discount of 9 per cent.

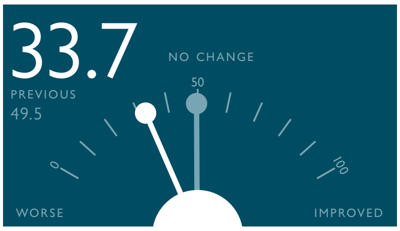
BOND INVESTOR DEMAND HALT AS COVID-19 INCREASE RISK

Substantially increasing yields on the secondary bond market suggests refinancing difficulties ahead. However, activity remains and pick up to be expected when Covid-19 fears settle.

AVERAGE DIVIDEND YIELD INCREASES SUBSTANTIALLY

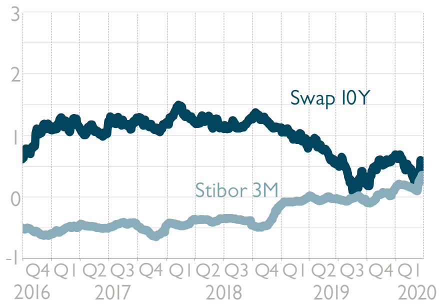
From the previous average dividend yield of around 5.7 per cent, preference shares decline sharply as yield stabilise above 7 per cent.

CREDI Main index



Banks	Corporates
31.3	36.1
43.0	56.0

Swedish key interest rates, 2016–2020. Per cent



Loan-to-value Q4 average	Interest rate Q4 average	Fixed credit term Q4 average	Fixed interest term Q4 average
52%	1.9%	3.3 y	3.0 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 49.5 to 33.7 as Covid-19 fears accelerate uncertainty among banks and corporates. Thus, CREDI Main index is recorded at its lowest point since its inception in 2012.

Main index components

From a previously stable credit market with the CREDI Main index at 49.5 in December 2019, respondents have clearly altered their views of the current situation and future expectations amidst Covid-19 fears. As a result, the Main index is recorded at its all-time low of 33.7.

The development of the Main index is driven by a major drop in both the Current Situation index and the Expectations index. Given the circumstances, the Current Situation index is lower than the Expectations index, indicating respondents are more positive going forward. However, as the Expectations index still remains well-below the 50-mark at 36.8, the current problems within debt markets are not expected to go away within the coming three months.

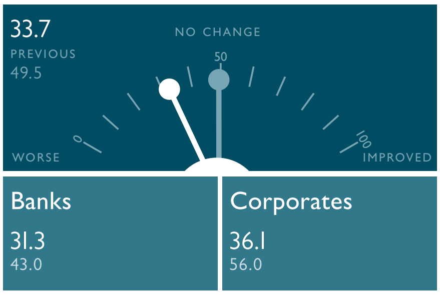
While the banks' Current Situation index decline from 48.4 to 37.5 and their Expectations index decline from 37.5 to 25.0, the corporates' Current Situation index decreases from 57.6 to 23.6 and their Expectations index drops from 54.4 to 48.6. Conclusively, banks are pessimistic about the current situation and believe that it will get even worse going forward, while corporates consider the current situation is as worse as it gets and holds a more positive outlook.

Much like previous editions of the CREDI Survey, banks are noticeably more pessimistic than corporates in their expectations. Thus, it could be considered that corporates consider the current situation as a more temporary crisis as opposed to banks.

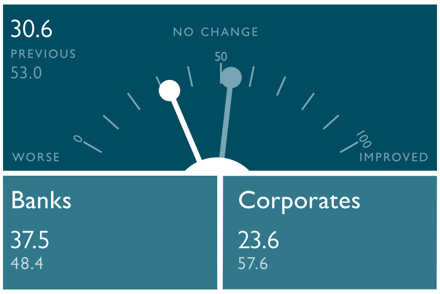
Sub-indices

The CREDI Main index is made up of eight underlying sub-indices. In the April survey of 2020, credit availability has worsened drastically and is expected to stay that way going forward. Credit margins have and will be increasing further as a result of increased risk premiums while leverage and credit duration has and will decrease further. Conclusively, the credit market faces major headwinds and is now in an entirely different state than it was in the December publication of CREDI.

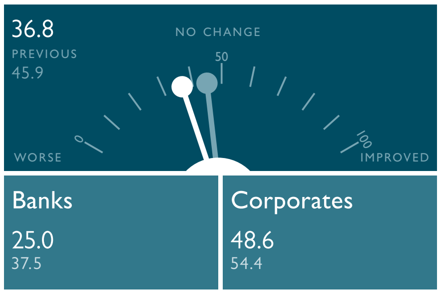
CREDI Main index



Current Situation



Expectation



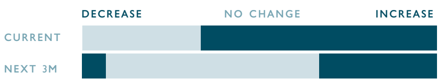
CREDI sub-indices

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.

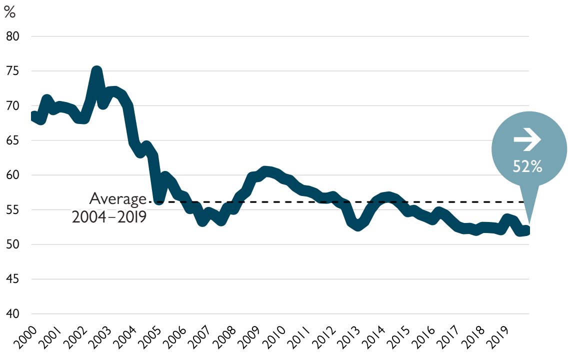
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 fourth quarter of 2019 saw only minor changes within the CREDI Indices. However, Covid-19 has increased refinancing risk substantially which will certainly impact debt strategies regarding fixed credit and interest terms going forward.

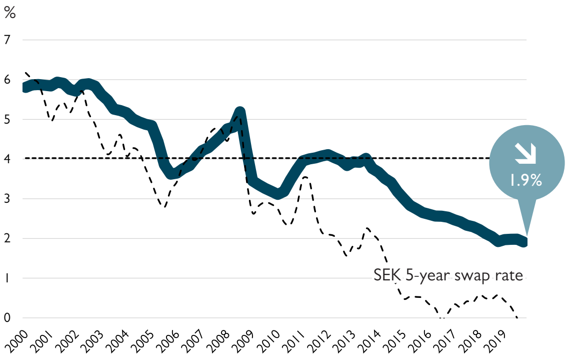
Listed sector Q4 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market remained at 52 per cent as aggregated debt and property values moved in proportion. 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.

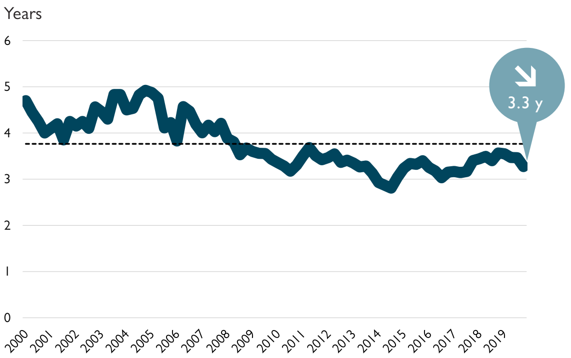
Listed sector Q4 average interest rate[2]



The average interest rate of listed property companies fell to 1.9 per cent in the fourth quarter of 2019. Currently, Hufvudstaden, Wallenstam and Diös all have industry-leading average interest rates of 1.2 per cent. During the quarter, Castellum, Brinova, SBB and Corem all decreased their average interest rates by more than 20 basis points.

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

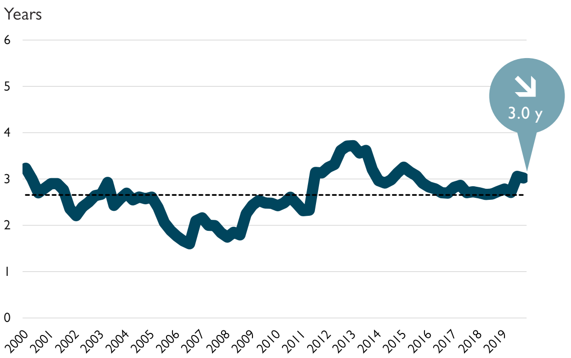
Listed sector Q4 average fixed credit term[3]



The average fixed credit term among listed property companies fell to 3.3 years in the fourth quarter of 2019, below the long-term average of 3.8 years. During the quarter credit terms where in general shortened while SBB distinctively lowered their average fixed credit term from 4.9 to 3.4 years. Going forward, average fixed credit term will become more important as refinancing risk is highlighted by the developments of Covid-19.

3 Average maturity referring to interest-bearing debt.

Listed sector Q4 average fixed interest term[4]



-------- Average 2000–2019

The average fixed interest term among listed property companies decreased slightly from 3.1 to 3.0 years as the current term remains above the long-term average of 2.7 years. Decreasing long-term interest rates continue to spark interest among corporates that 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.

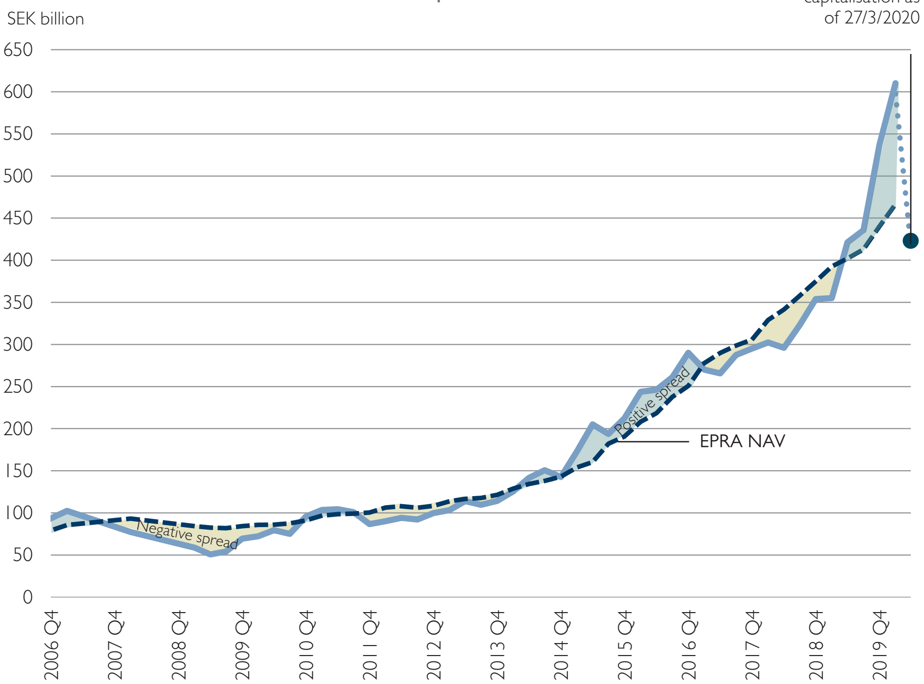
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

In the last quarter of 2019 premiums reached a record 31 per cent. Enter Covid-19 and a subsequent historic drop in market capitalisation that resulted in a shift to discount of 9 per cent.

The last quarter of 2019 followed on the previous quarter trend where the market capitalisation of the property-related listed shares on the Nasdaq Stockholm Main Market soared, finishing with an impressive yearly increase of 72 per cent. With market capitalisation at a record SEK 610 billion and EPRA NAV at SEK 467 billion, the premium at the end of the fourth quarter was at 31 per cent. Moving into 2020, things have changed drastically with the development of Covid-19 and a simultaneous oil crisis. As of 27/3/2020, market capitalisation has decreased to SEK 423 billion, implying a 9 per cent discount. However, today's market capitalisation does not imply any major write-downs in the companies' book values. The economic effects of Covid-19 are yet unclear and difficult to estimate, suggesting volatile markets ahead.

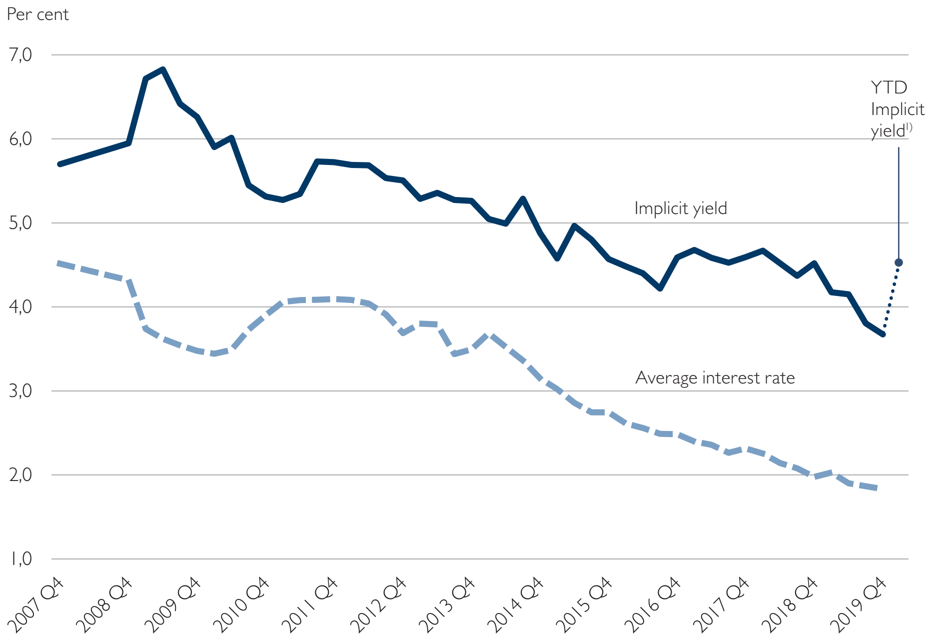
Premium or discount – market capitalisation and EPRA NAV



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 a tax rate of 22 per cent.

The implicit yield of listed property companies fell further below 4 per cent to 3.7 per cent in the end of the fourth quarter. The spread between listed property companies implicit yield and their average interest rate was approximately 1.8 per cent, but has now changed drastically as implicit yields have soared in response to declining market capitalisation. As of 27/3/2020, the implicit yield stands at 4.6 per cent, the same level it was in the last quarter of 2017. Going forward, the spread between implicit yield and average interest rate will likely temporarily widen as it did during the financial crisis in 2008. The reason for this is that the implicit yield is based on the equity market capitalisation which changes faster than the quarterly reported average interest rate.

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



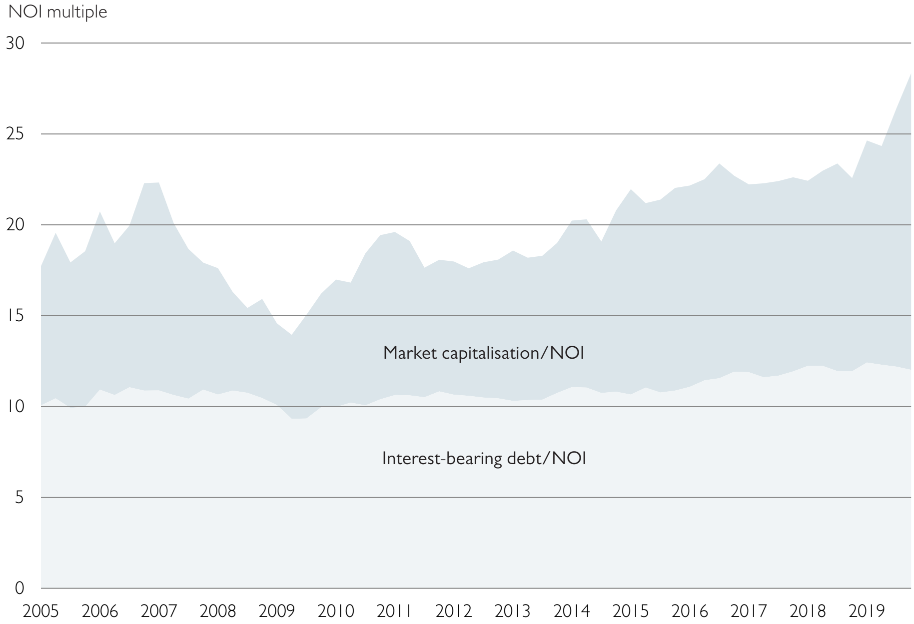
[1)] Market values 27/3/2020 and 2019 Q4 EPRA NAV.

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, corresponding to 5.5 per cent when considering a tax rate of 22 per cent.

Source: Catella, annual reports, Nasdaq.

Interest-bearing debt decreased marginally from 12.2 to 12.0 times net operating income in the fourth quarter of 2019, while market capitalisation continued on the previous quarter surge by increasing from 14.2 to 16.3 times net operating income. The more recent developments on the stock market suggest quite a drastic decline in the market capitalisation to net operating income multiple going forward. Under more normal circumstances the interest rate is a main driver of the market capitalisation over net operating income multiple. Even though interest rates have been slashed, market capitalisation has descended sharply lately, a result of risk aversion and increasing risk premiums.

Interest-bearing debt and market capitalisation in relation to NOI



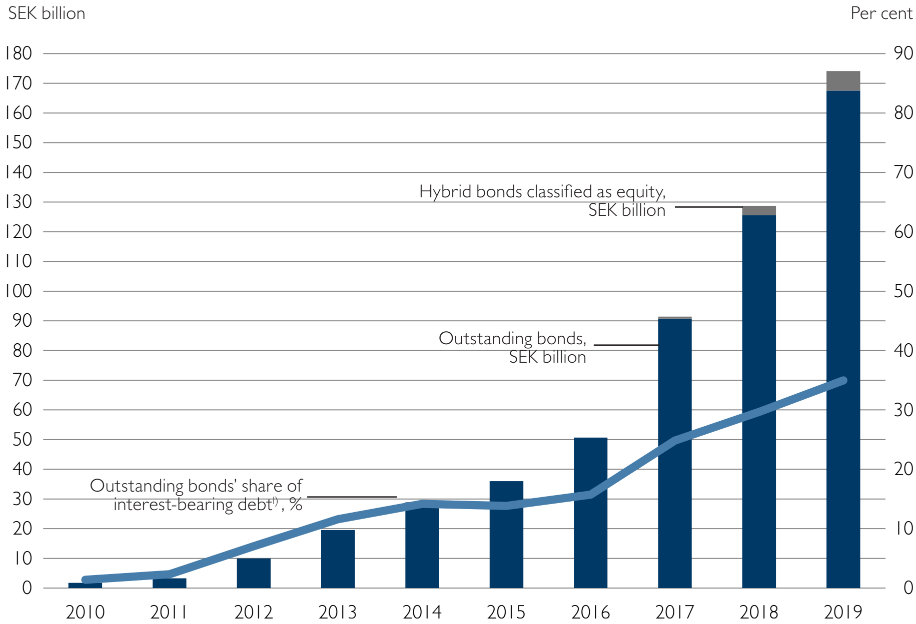
Note. Property companies on Nasdaq Stockholm Main Market.

Bonds

Bond markets for property-related companies remained stable in the fourth quarter as the outstanding volume increased to SEK 168 billion. Moving into 2020, Covid-19 outbreak has hampered investor demand.

In the fourth quarter of 2019 the market for property-related corporate bonds remained stable and increased from SEK 162 billion to SEK 168 billion (35 per cent of total interest-bearing debt). SBB and Hufvudstaden were the most active during the quarter as they increased their bond exposure by around SEK 7.3 billion and SEK 1 billion respectively. Going into 2020, market activity has been generally high with issuances at record-low yields. However, the recent developments of Covid-19 have severely impacted bond investor demand, as bond yields increased substantially. Notably, SBB still managed in the middle of the crisis to issue an additional unsecured bond with a 20 year term amounting to EUR 50 million. As such, bond market activity remains and a quick pick up can be expected when and if the Covid-19 spread is contained.

Outstanding bonds



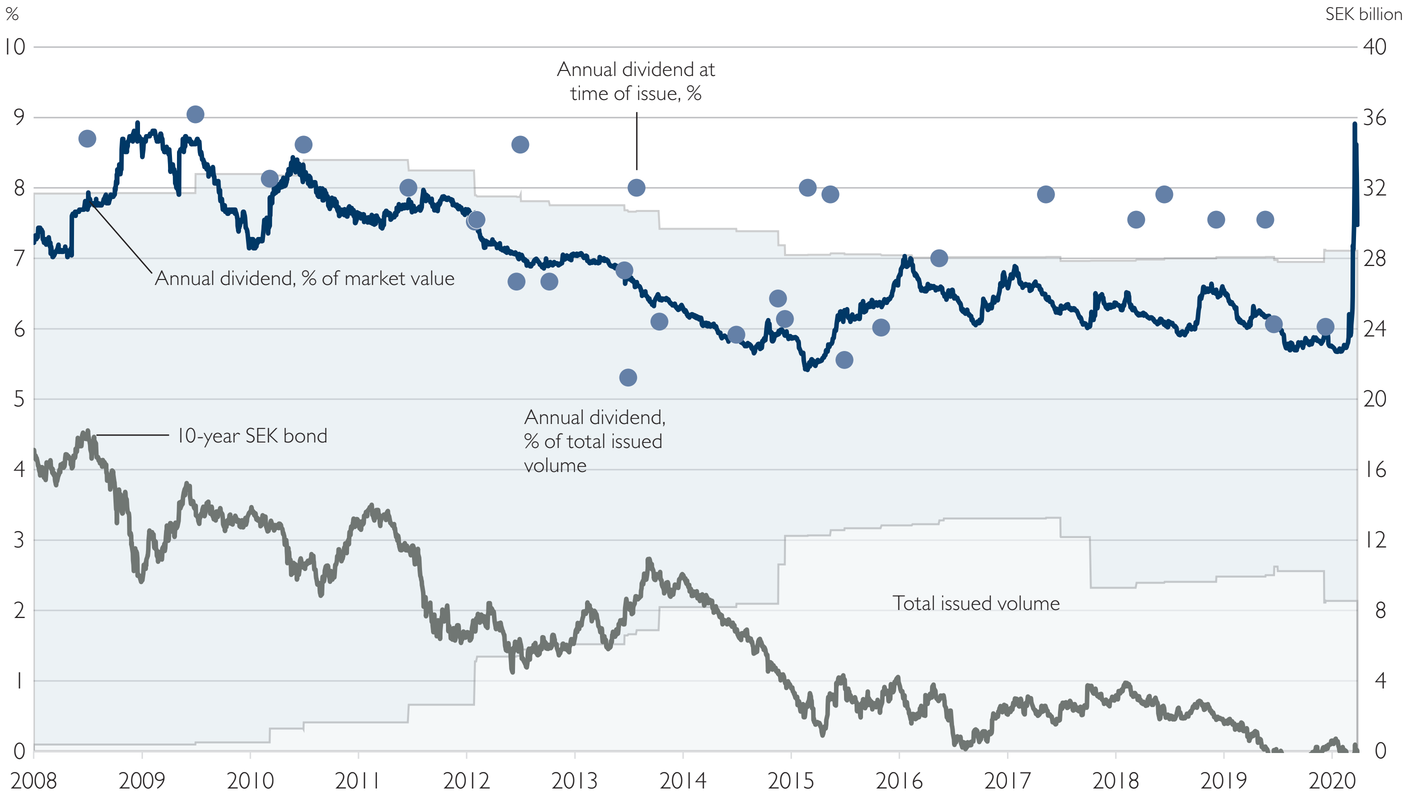
[1] Excluding hybrid bonds classified as equity.

Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The average dividend yield of property-related preference shares is above 7 per cent as investors' increase their risk premiums amidst Covid-19 crisis.

Property companies' preference shares on Nasdaq Stockholm Main Market



In the fourth quarter of 2019, the average dividend yield in the secondary market for property-related preference shares remained at around 5.8 per cent. It remained there around until March, where developments on the stock markets related to Covid-19 abruptly changed sentiment. In just two weeks, the average dividend yield went from around 6.0 per cent to almost 9.0 per cent. Since then, then market has bounced back somewhat and as of 27/3/2020, the average dividend yield is at 7.5 per cent. Interestingly, as we can see in the graph these numbers are rather similar to what they were amidst the financial crisis in 2008. However, during this time only Sagax's preference share was included as they were pioneers in the then not so developed market for preference shares in Sweden.

Looking at the different segments, it seems that the developments of Covid-19 have caused investors to especially increase their risk premiums for office, industrials and development property companies. Klövern and NP3 are the most affected yet being traded with average dividend yields above 7 per cent, bearing in mind that Klövern is the most liquid preference share with the largest market cap on the Swedish secondary market for preference shares, while Sagax seems to have fended off the market development quite well with an average dividend yield still below 6 per cent (however it was momentarily above 7 per cent).

During the last quarter of 2019 and before the recent turbulence there was some market activity on the secondary market for property-related preference shares. K2A issued a further SEK 100 million of their preference share while Hemfosa's preference share was traded for SBB's class D common shares as a part of the takeover of Hemfosa. As such, the trend with a growing market for Class D common shares has continued.

Catella's view through the looking glass

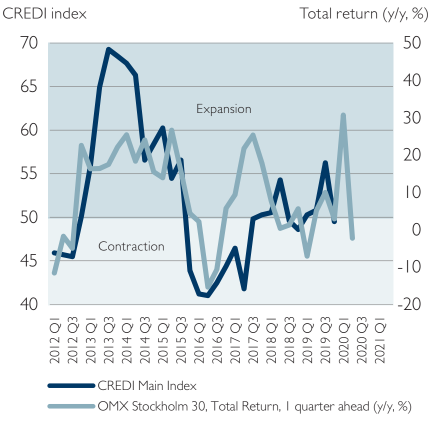
The spreading of Covid-19 in Europe and the USA has been a game changer on the financial markets. Both S&P 500 and most European markets have entered bear market territory (although there was a strong comeback between March 23 and 31) and the economic activities are slowing down to standstill in most European countries.

The activity on the Swedish property market was strong during the autumn, the rolling 12-months transaction volume was just above SEK 163 billion in late March, a slight increase from the 2019 full-year volume of around SEK 158 billion (excluding indirect transactions).

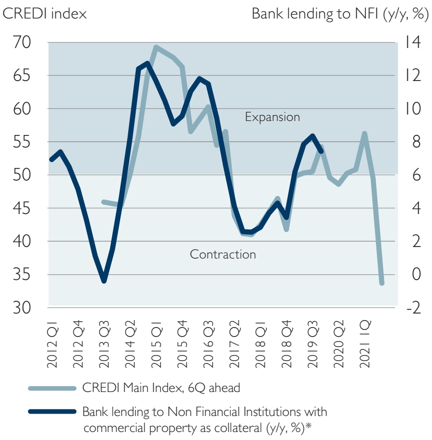
The CBOE Volatility Index (VIX) increased to over 80 late on March 16, which is over the highs of November 2008 (it has fallen back to around 60 now). This is an indication that the market is expecting extremely high equity market volatility and is indicating risk aversion on financial markets going forward. Consequently, junk bond funds have seen large outflows and US high-yield bond risk premiums have climbed sharply. The yield spread between high and lower rated investment grade bonds has also increased markedly lately, as the market is becoming more risk averse. The ECB and the Riksbank (and several other central banks) have injected significant amounts of liquidity and stimulative measures as a response to this. Companies with high risk in their business models on the Swedish property market will likely have problems to refinance their debt going forward (and their debt will be significantly more expensive than before in any case). However, prime property will always be an attractive alternative to government and corporate bonds when interest rates are extremely low.

In the longer term, however, we have probably entered a new phase in the global economy now with increasing trade barriers, competitive devaluations (currency war), increasing political pressure on central banks to accept higher inflation, and extremely expansive fiscal policies more or less directly financed by the central banks. The effect will probably be a pressure upwards on inflation in 18–24 months' time. Even if property is negatively affected by higher interest rates, it is also a real asset with (in most cases) inflation linked lease agreements. This will likely make property an attractive asset class also going forward, especially residential, public properties and mixed commercial properties in large and regional cities.

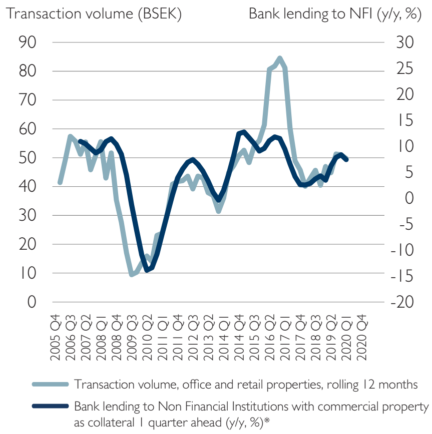
CREDI Main index and OMX Sthlm 30



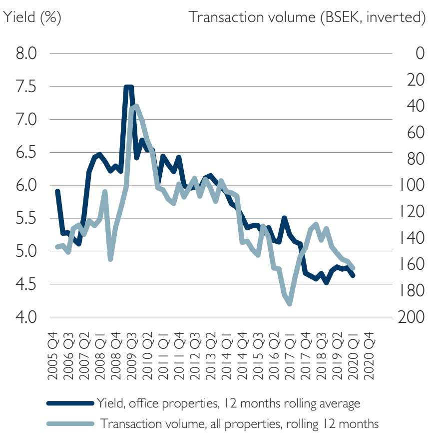
CREDI Main index and bank lending



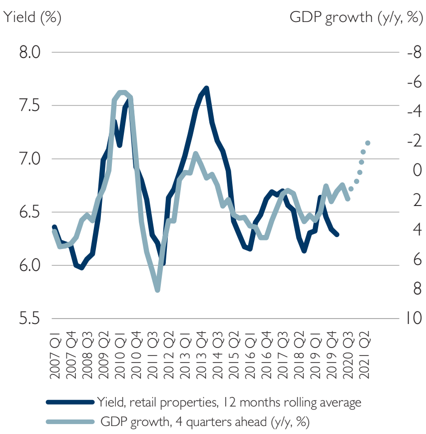
Transaction volume and bank lending



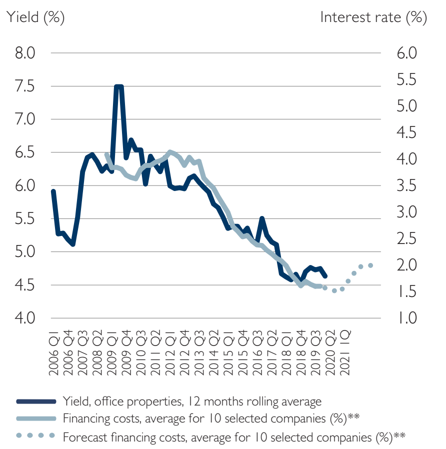
Average office yields* and transaction volume



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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