CREDI July 2020

Credit sentiment improves as corporates expect strong recovery

In the July issue of CREDI, the Main index increases from 33.7 to 40.4 as corporates have strong expectations of a near future recovery while the current situation is deemed gloomy by both banks and corporates.

CREDI SURVEY HEAVILY INFLUENCED BY THE PANDEMIC

The CREDI Survey reflects the ongoing pandemic as the Current Situation index is at 24.6 while the Expectations index is noticeably more positive at 56.3.

CORPORATES EXPECT A STRONG RECOVERY IN THE NEAR FUTURE

While both banks and corporates consider the current situation negative with both Current Situation indices well-below the 50-mark, corporates expect a strong recovery going forward with their Expectations index at 69.8.

CREDI INDICES ILLUSTRATES REVISED DEBT STRATEGIES

Increased risk of refinancing caused corporates to revise their debt strategies as investors turned more selective towards shorter credit terms but responded well to announced actions.

PREVIOUS RECORD PREMIUM REVERTS TO PAR

A near 40 per cent drop in market capitalisation seems dramatic but the annual change remains positive and valuations are at par with EPRA NAV.

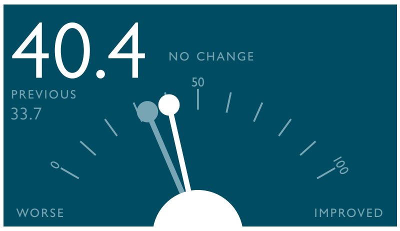
CORPORATES TAP EUROPEAN BOND MARKET FOR CAPITAL

Outstanding bond volume increases to SEK 187 billion as corporates issue bonds on the European bond market. Liquidity on the Swedish bond market has improved but is still limited and credit spreads are relatively high.

ACTIVITY ON SECONDARY MARKET FOR PREFERENCE SHARES

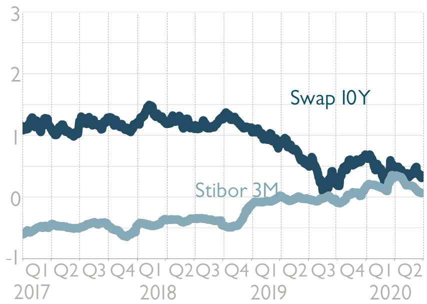
From an average dividend yield momentarily close to 9 per cent, the market has recovered to an average dividend yield below 7 per cent with subsequent directed offering activity.

CREDI Main index



Banks	Corporates
30.4	50.5
31.3	36.1

Swedish key interest rates, 2017–2020. Per cent



Loan-to-value Q1 average	Interest rate Q1 average	Fixed credit term Q1 average	Fixed interest term Q1 average
↗ 53%	↗ 2.0%	↗ 3.5 y	↗ 3.2 y

About CREDI: The Catella Real Estate Debt Indicator, CREDI, is a market sentiment indicator for the Swedish real estate debt financing market. CREDI consists of two parts; a quarterly current and forward-looking survey of Swedish listed property companies and banks providing real estate financing on the Nordic market; and a set of indices based on publicly available data illustrating the aggregate change in credit conditions such as leverage, duration and cost of debt for the Swedish listed property sector.

The CREDI Survey

In the July publication of CREDI, the Main index increases from 33.7 to 40.4 as respondents have strong expectations of a future recovery but are noticeably influenced by the ongoing pandemic in their current perceptions.

Main index components

The April publication of CREDI resulted in the lowest CREDI Main index ever recorded. Since then, sentiment has turned more positive where economies are gradually re-opening, indicating business activity can revert to normal in the near future. This is clearly mirrored in respondents' answers, where both corporates and banks consider the current situation gloomy but are noticeably more positive in their expectations of what the coming three months will bring. Conclusively, the Main index is recorded at 40.4, up from the previous all-time low 33.7.

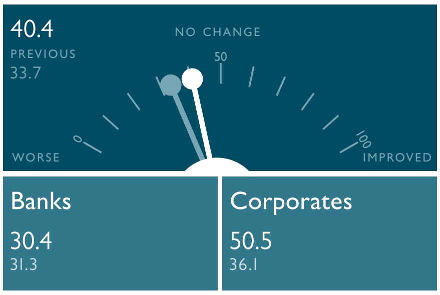
As stated, respondents have been rather negative about the current situation. In fact, the Current Situation index is recorded at its all-time low of 24.6, even worse than the previous CREDI. Banks are noticeably more negative than their corporate counterparts, per usual, as banks' Current Situation index is at 17.9 compared to corporates' 31.3. Both remain well-below the 50-mark as the pandemic still harrows and is yet to be contained.

Going forward, respondents are noticeably more optimistic. The Expectations index for banks and corporates are recorded at 42.9 and 69.8 respectively. Continuing the same theme, banks are a bit more restrictive in their predictions while corporates believe in a strong recovery in the months after summer. In aggregate, the Expectations index is at 56.3 suggesting positive sentiment ahead which is mainly driven by corporates strong belief in a quick recovery.

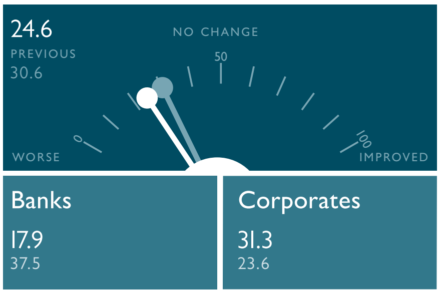
Sub-indices

The CREDI Main index is made up of eight underlying sub-indices. According to respondents in the July survey of 2020, credit availability has worsened drastically while credit margins have increased. At the same time, the situation for leverage and duration is also causing headwinds. Going forward, respondents see much more positive sentiment with better credit availability, lower credit margin and increased duration while leverage will decrease further.

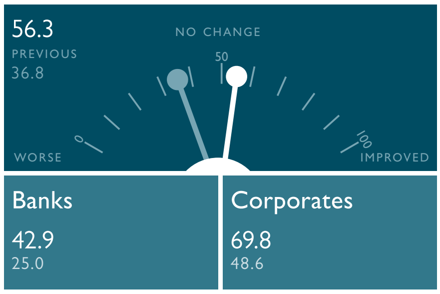
CREDI Main index



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.

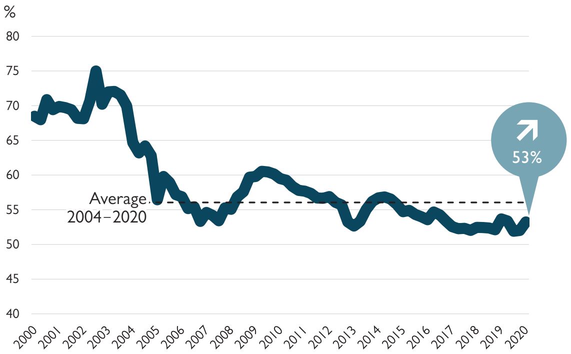
The CREDI Survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 2020 illustrated changes related to the ongoing pandemic. Refinancing risk, interest rate developments and general uncertainty defined the actions of property companies during the quarter.

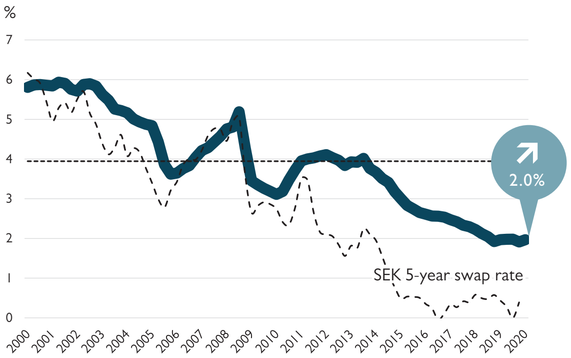
Listed sector QI average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market increased to 53 per cent as interest-bearing debt levels increased more than property values during the quarter. However, 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.

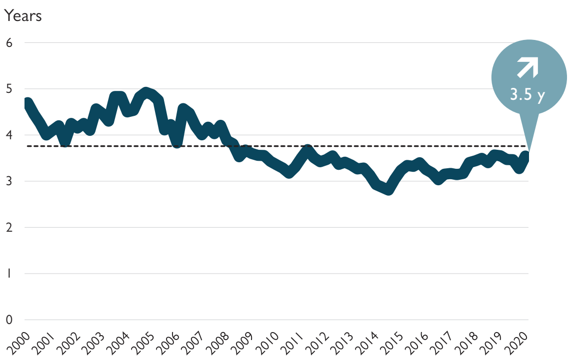
Listed sector QI average interest rate[2]



The average interest rate of listed property companies increased marginally by 10 basis points to 2.0 per cent in the first quarter of 2020. Notably, Hufvudstaden is no longer best-in-class as their average interest rate increased from 1.2 per cent to 1.4 per cent. Also, Castellum increased their average interest rate by 50 basis points to 1.9 per cent. Wallenstam, Heba, Diös and Wihlborgs are now shared industry-leaders with average interest rates of 1.3 per cent.

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

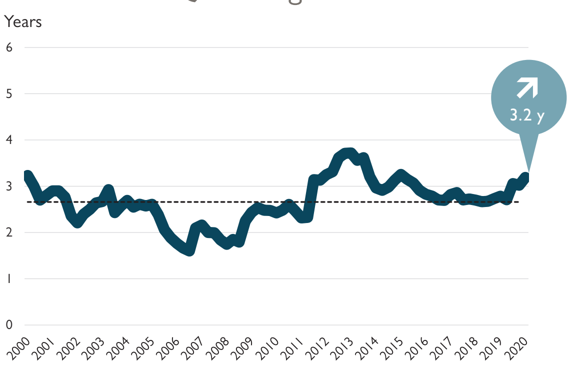
Listed sector QI average fixed credit term[3]



The average fixed credit term among listed property companies increased from 3.3 to 3.5 years in the first quarter of 2020. During the quarter credit terms where in the spotlight as investors weighed refinancing risk in the evolving pandemic. Thus, the market punished property equities with shorter credit terms, causing property companies to act swiftly by acquiring much of their short-term debt and securing more long-term solutions where possible.

3 Average maturity referring to interest-bearing debt.

Listed sector QI average fixed interest term[4]



-------- Average 2000–2020

The average fixed interest term among listed property companies increased in tandem with fixed credit terms from 3.0 to 3.2 years. Uncertainties with the ongoing pandemic and a generally good offer on longer term rates caused wary property companies to act accordingly and the current term remains above the long-term average of 2.7 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 QI 2000.

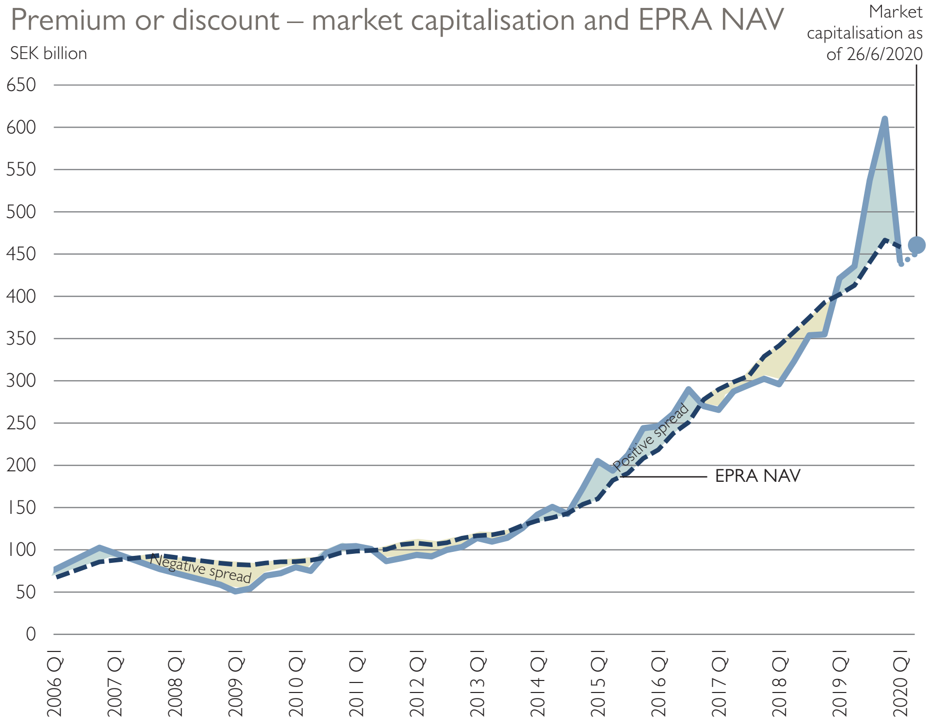
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

The market for property-related shares turned bearish amidst the pandemic as previous record premium of 30 per cent shifted to slight discount during the first quarter of 2020. The drop in market capitalisation looks dramatic but the annual change remains positive as shares subsequently reverted to fundamental value.

In the first quarter of 2020 listed property-related shares on the Nasdaq Stockholm Main Market faced major headwinds from the Covid-19 pandemic as market capitalisation decreased from SEK 610 billion to SEK 442 billion, creating a major shift from a 30 per cent premium to a 4 per cent discount. This suggests a quarterly drop of around 40 per cent. However, in comparison to the first quarter of 2019, the change in market capitalisation is positive at around 5 per cent. Thus, the Covid-19 pandemic triggered a reversion to fundamental value which only looks like a full-blown crisis due to the previous two quarters' massive gains in market capitalisation. As of 26/6/2020, market capitalisation has increased slightly to SEK 458 billion, implying property companies are currently valued on par with EPRA NAV.

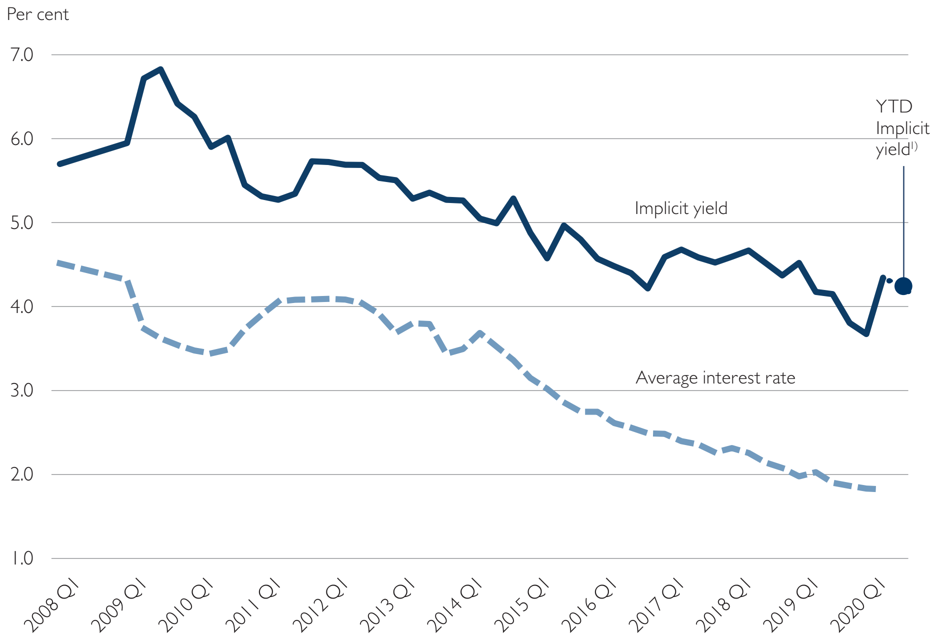
Premium or discount – market capitalisation and EPRA NAV



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.

Following the shift from premium to discount, the implicit yield of listed property companies is back above the 4 per cent mark at around 4.3 per cent from the previous record-low 3.7 per cent. As such, the spread between listed property companies implicit yield and their average interest rate has widened, explained by increased equity risk premiums following uncertainties amidst the Covid-19 pandemic. The spread is now at around 2.5 per cent, in comparison the spread peaked at around 3.2 per cent during the financial crisis. Any added risk premium on debt is yet to be visible in the first quarter of 2020 as the weighted average interest rate for listed property companies remains at 1.8 per cent.

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



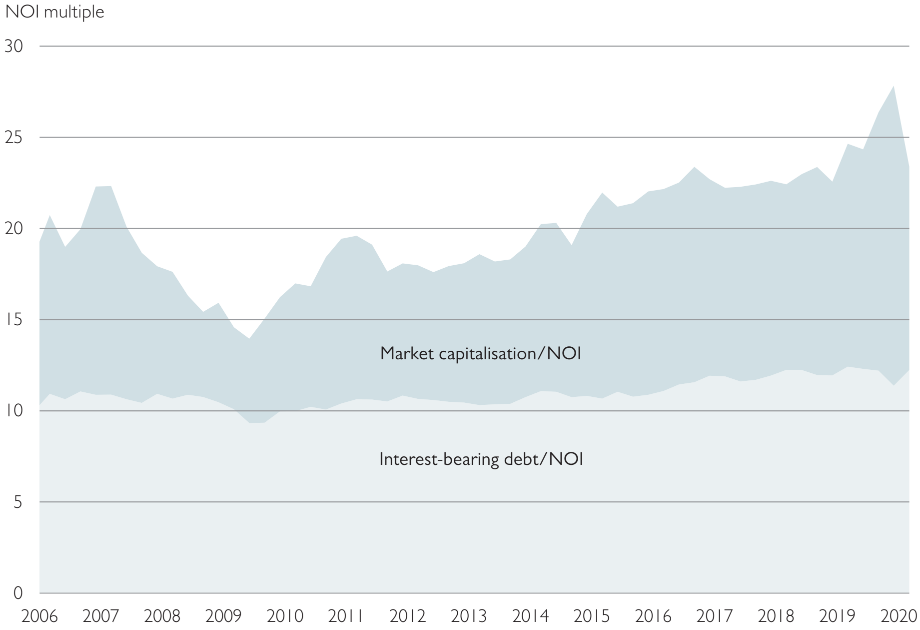
[1] Market values 26/6/2020 and 2020 Q1 EPRA NAV.

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

Source: Catella, annual reports, Nasdaq.

Interest-bearing debt increased from 11.4 to 12.2 times net operating income in the first quarter of 2020, while market capitalisation fell sharply from 16.5 to 11.2 times net operating income. Even though market capitalisation is at a higher level than it was in the first quarter of 2019, the multiple is now lower than it was at that time, suggesting relatively higher net operating income. While reported net operating income has not yet suffered any major impact from the Covid-19 pandemic, the second quarter reports should further illustrate the actual cash flow effects from the pandemic. The question is whether the market has already taken this into consideration. The current market capitalisation is in line with property valuations, suggesting a further decline in market capitalisation if property fundamentals turn out worse than expected due to the pandemic.

Interest-bearing debt and market capitalisation in relation to NOI



Note. Property companies on Nasdaq Stockholm Main Market.

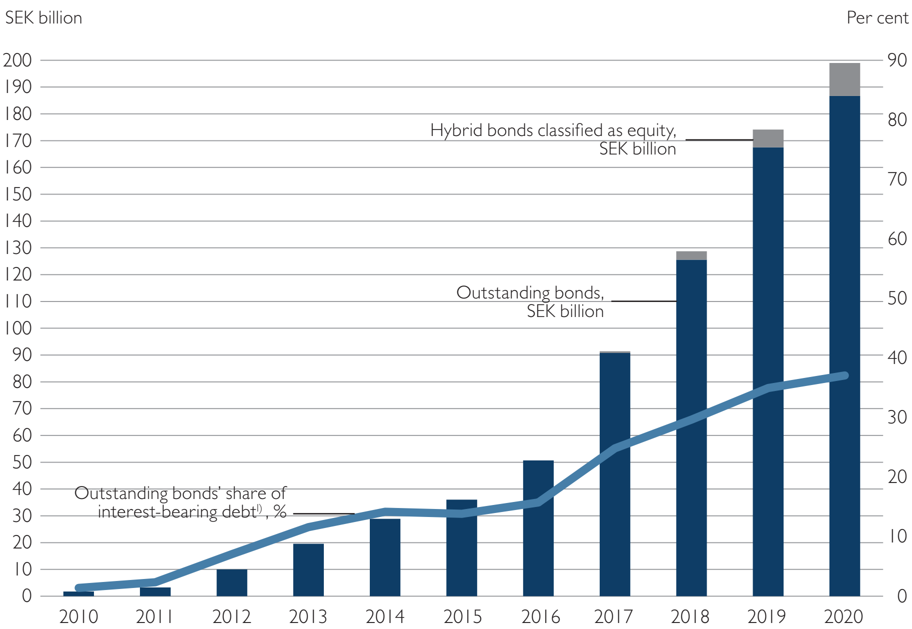
Bonds

Bond market activity remained high despite the ongoing pandemic as property companies tapped European bond markets for capital in favour of the Swedish bond market.

The volume of outstanding corporate bonds issued by property companies listed on the Nasdaq Stockholm Main Market, excluding hybrid bonds classified as equity, is now at SEK 187 billion, up by 11.4 per cent since the last quarter and up nearly 40 per cent since the first quarter of 2019. As SBB issued additional hybrid bonds, the aggregated volume including hybrid bonds classified as equity is close to the SEK 200 billion-mark.

Going forward, further growth seems plausible as global bond markets still attract great interest from both investors and corporates. Efforts to mitigate the illiquidity and valuation problems with the Swedish bond market are being considered and the Riksbank has announced that it will intervene in the market and start buying corporate bonds from September 1st.

Outstanding bonds



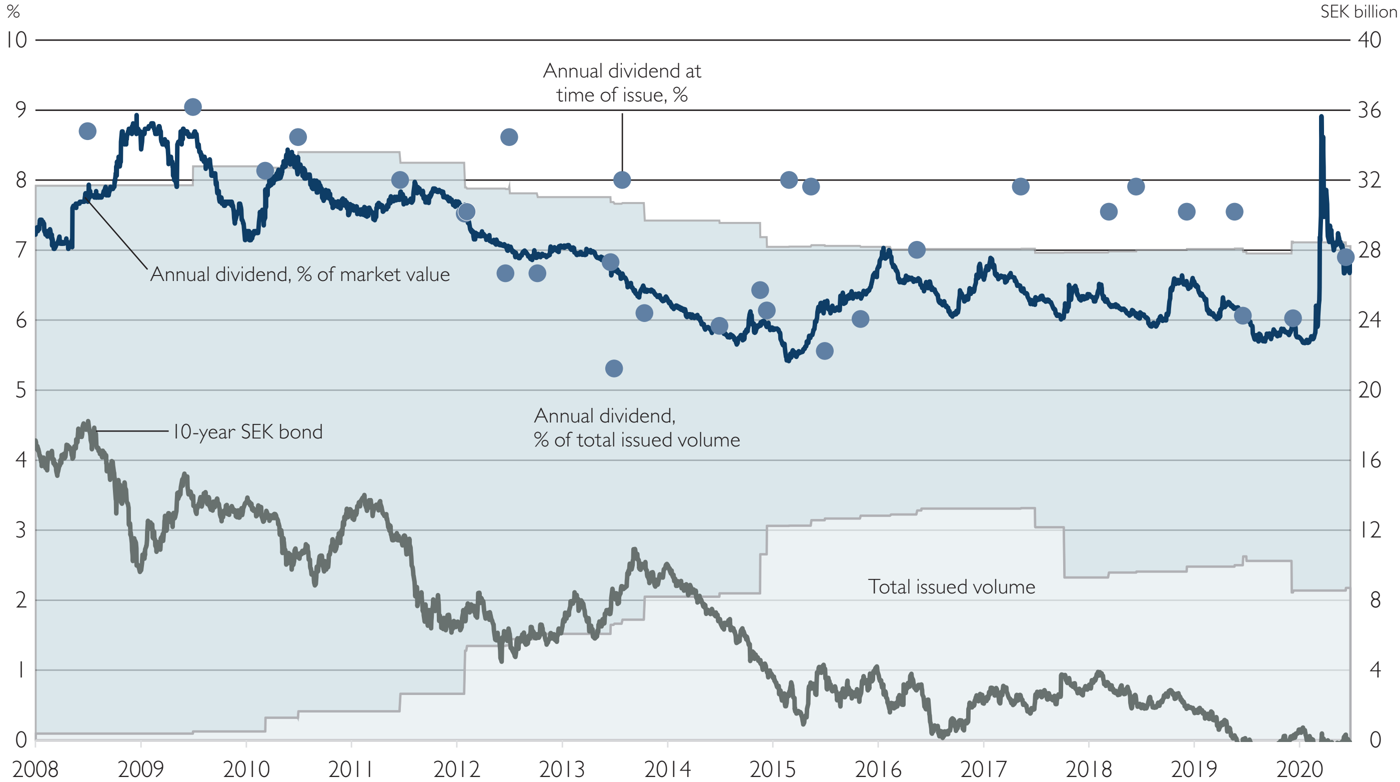
[1] Excluding hybrid bonds classified as equity.

Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The secondary market for property-related preference shares experienced extreme volatility amidst the pandemic. A stabilised average dividend yield together with a successful directed offering suggests the market has recovered.

Property companies' preference shares on Nasdaq Stockholm Main Market



The secondary market for property-related preference shares experienced major volatility. Pricing has never shifted this abruptly in the life span of this market and the average dividend yield reached nearly 9 per cent during the quarter. Thereafter, the recovery was just as quick and new support have been found around 7 per cent. As of 26/6/2020, the average dividend yield for property-related preference shares is at 6.75 per cent.

The pandemic has certainly highlighted the variations within the different property segments. During the extreme volatility, a larger variation could be identified from the previously rather aligned dividend yields with only minor sector variations. In line with the general investor trend during the pandemic, commercial segments, mainly hotel, retail and office, have been disregarded in favour of safer cash flow segments such as residential and public. Although the selection of property-related preference shares is limited and doesn't cover all these segments, clearer variations could be identified. For example, companies such as NP3 and Klövern were momentarily traded close to 9 per cent dividend yield in March at the same time as Sagax and Fastpartner were traded around 7 per cent dividend yield. Of course, this is not only due to segmentation but also has to do with other types of company-specific risks such as leverage. However, the variations that occurred is an interesting take-away and now as the market seems to have stabilised, average dividend yields have yet again reverted to normal variations.

Another indicator of a stabilised market is that NP3 managed to issue further 3.1 million preference shares in a direct offering for SEK 29 per share and a dividend yield of 6.9 per cent. In comparison, the NP3 preference share was as previously stated momentarily traded close to 9 per cent dividend yield, suggesting investors now consider the market considerably more stable.

Conclusively, the market for property-related preference shares remains liquid and might be considered as an alternative when the Swedish bond market has limited liquidity and relatively high credit margins. However, the alternative class D common share remains more popular and thus we are more likely to see further activity in that sector going forward.

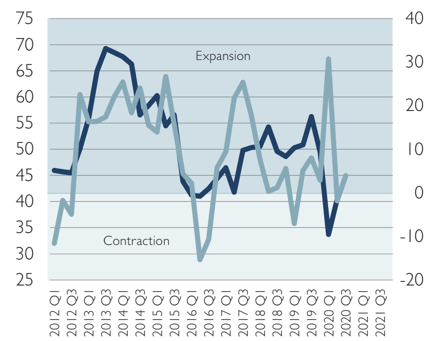
Catella's view through the looking glass

The OMX Stockholm 30 has recovered over the last months and is only around 10 per cent below its peak from February 21. Investors are now adjusting their yield expectations for all types of assets according to their long-term macro view of low growth, low inflation and low interest rates going forward. As such, property investors expect improving credit sentiment in the near future.

There have been major changes in demand and activity between the property segments since the pandemic erupted. The property transaction market is currently driven by institutional investors and demand is tilted towards well-located properties in the major cities within the public property, residential rental property and prime logistics segments. Investors demand stable cash flows where rental growth follows inflation and the vacancy risk is low. If one look broader to all Swedish listed property companies there are equity market discounts to NAV for companies with a focus on hotel, retail and/or office properties, while there are significant premiums on companies with mix industrial properties, well-located logistics and residential apartment properties in their portfolios. In fact, the implicit property yields based on the equity market valuation are well in line with the average valuation yields in most property segments. The property segments that stands out are prime offices, shopping centres and big-box properties which all have higher implicit yields than average valuation yields while prime logistics and industrial properties and residential properties have lower implicit yields than average valuation yields.

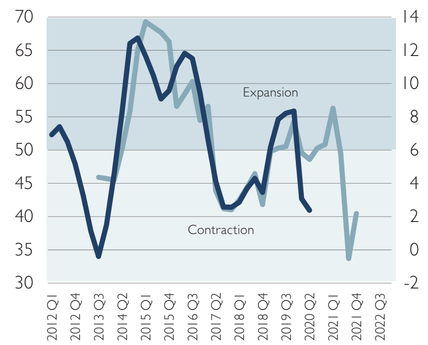
Institutional investors around the world have gradually increased their allocation to alternative assets (including property) over the last decade and this is expected to continue as long as this consensus macro view of low interest rates prevails. Many investors fear that broad equity markets have gone well above fundamentals, and it is quite likely that we will see a major equity market correction during the coming months. If this correction ends up at around 20–30 per cent, the authorities will need to respond with even more fiscal and monetary support (otherwise the global economy may end up in a deflation spiral and collapse under its debt load). The property market responds very well to central bank liquidity, even better than the broad equity markets. As a result, property will likely remain a highly attractive asset class also during the coming 6–12 months and yields for the segments that are prioritised by the institutional investors may even keep on declining.

CREDI Main index and OMX Sthlm 30



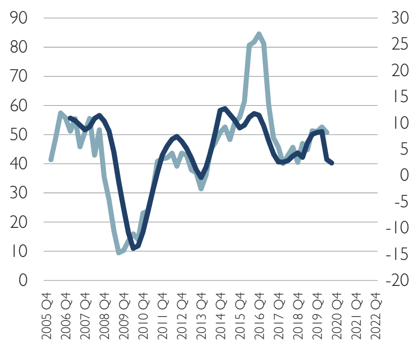
CREDI Main Index
OMX Stockholm 30, Total Return, 1 quarter ahead (y/y, %)

CREDI Main index and bank lending



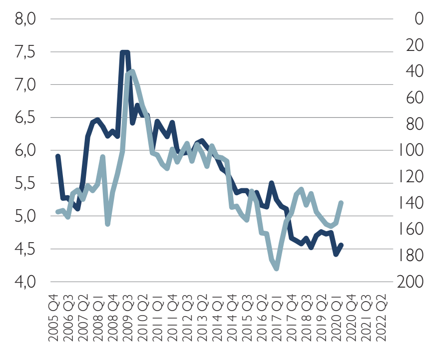
CREDI Main Index, 6Q ahead
Bank lending to Non Financial Institutions with commercial property as collateral (y/y, %)*

Transaction volume and bank lending



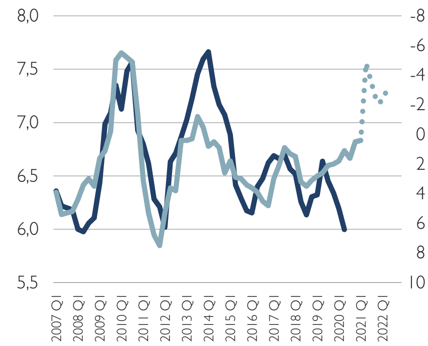
Transaction volume, office and retail properties, rolling 12 months
Bank lending to Non Financial Institutions with commercial property as collateral 1 quarter ahead (y/y, %)*

Average office yields* and transaction volume



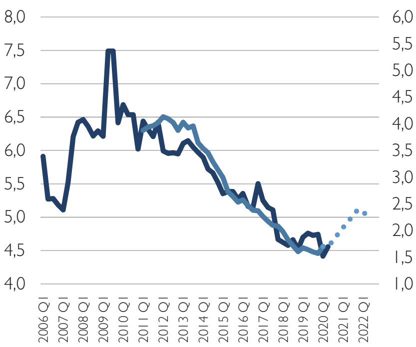
Yield, office properties, 12 months rolling average
Transaction volume, all properties, rolling 12 months

Average retail yields* and GDP growth



Yield, retail properties, 12 months rolling average
GDP growth, 4 quarters ahead (y/y, %)

Average office yields* and average financing costs**



Yield, office properties, 12 months rolling average
Financing costs, average for 10 selected companies (%)**

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

Catella is a European financial advisor and asset manager. In Sweden, Catella is a market leader for advisory services in connection with property transactions and property-related services within debt and equity capital markets. We have offices in Stockholm, Gothenburg and Malmö.

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