CATELLA

CRED>I
CATELLA REAL ESTATE DEBT INDICATOR

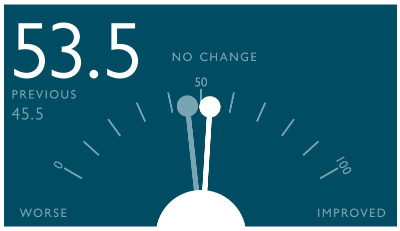
CREDI March 2021

Improved credit market sentiment as optimism returns among corporates

In the March issue of CREDI the Main index increases from 45.5 to 53.5 as corporates turn optimistic with regards to improved credit availability and decreased credit margins.

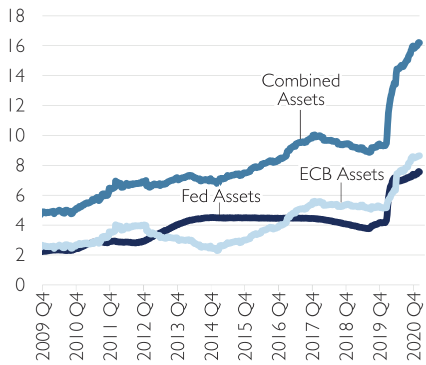
- The CREDI Main index is back above the 50-mark as corporates' positivity outweigh banks' more pessimistic view on the sector following increased credit availability, lower credit margins and increased duration.
- Bond market is back at pre-pandemic levels as spreads decrease following fiscal and monetary stimulus by central banks as well as limited supply of new issuances to meet amplified investor demand.
- The CREDI Survey results together with the absence of net lending towards the real estate sector during the second half of 2020 suggest increased bank appetite for real estate financing in the first quarter of 2021 while bond market remains a competitive alternative.
- Sagax announces redemption of all preference shares while SBB announces last day of trading for their preference shares. Alternative financing through hybrid equity or class D common shares continuously more attractive.

CREDI Main index



Banks	Corporates
46.1	61.0
44.6	46.3

Central bank balance sheet, assets
USD Trillion



Loan-to-value Q4 average: 54%	Interest rate Q4 average: 1.9%	Fixed credit term Q4 average: 3.2 y	Fixed interest term Q4 average: 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. Subscribe to CREDI at catella.se/CREDI

The CREDI Survey

The March issue of the CREDI Survey suggests a stable credit market as the Main index increases from 45.5 to 53.5 following increased credit availability and lower credit margins.

MAIN INDEX COMPONENTS

In the March issue of CREDI, the Main index bounces from 45.5 to 53.5 as respondents experience better credit availability and lower credit margins. The shift above the 50-mark suggests an improved credit sentiment since the December survey which is mainly driven by positive sentiment among corporates with a Main index of 61.0. Banks however continue to be more pessimistic with their Main index recorded at 46.1.

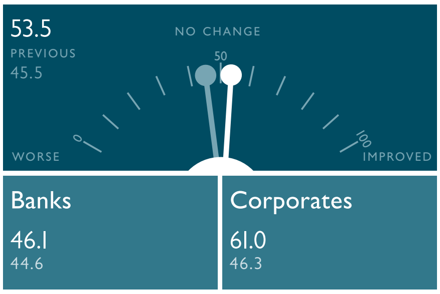
In aggregate, the Current Situation index is recorded at 54.1 as respondents see better credit availability, lower credit margins and to some extent increased duration. Also, near-term expectations seem positive with the Expectation index recorded at 52.9.

Coming back to the divided opinions among banks and corporates, banks deem the current situation about the same as the near-term future expectations with their Current Situation index at 45.3 and Expectation index at 46.9. At the same time, corporates' Current Situation index is recorded at 63.0 while the Expectation index is recorded at 59.0. Conclusively, corporates outweigh banks as the CREDI Survey suggest positive credit sentiment both today and going forward.

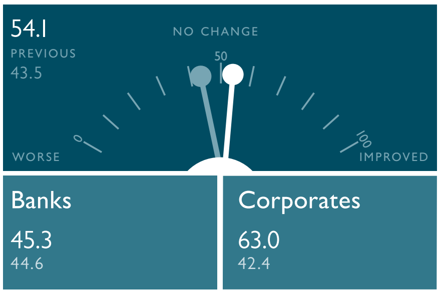
SUB-INDICES

The CREDI Main index is made up of eight underlying sub-indices. According to respondents in the March survey of 2021, credit availability was strong, credit margins was lower while duration increased, and leverage was slightly lower. Notably, credit availability and credit margins seem to have been the main drivers of the positive credit sentiment. Going forward, the theme remains similar while some corporate respondents are hoping for increased leverage.

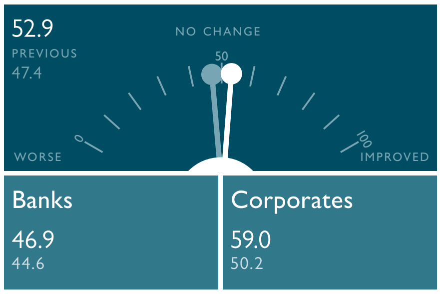
CREDI Main index



Current Situation



Expectation



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.

CREDI Sub-indices

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 last quarter of 2020 illustrated minor changes within the CREDI Indices while individual changes within average interest rates are in line with current investor sentiment.

During the quarter, there were only minor changes within the CREDI Indices as average interest rate remained at 1.9 per cent, LTV decreased slightly from 55 to 54 per cent, fixed credit terms decreased from 3.4 to 3.2 years and fixed interest term increased slightly from 3.0 to 3.1 per cent.

Heba lowered their average interest rate by 16 basis points to 1.15 per cent making them the property company with the lowest average interest rate in the segment. At the same time, Pandox increased their average interest rate by 20 basis points to 2.60 per cent. The above changes are in line with the pandemic related shift in investor sentiment we've seen on the transaction market, with increased investor focus on safer assets such as residential properties (Heba) and less focus towards office, hotels (Pandox) and retail. Although there could be various reasons to individual changes in average interest rate, there are increasing signs of banks changing their individual risk premiums depending on sub-sector outlook.

ABOUT THE CREDI INDICES

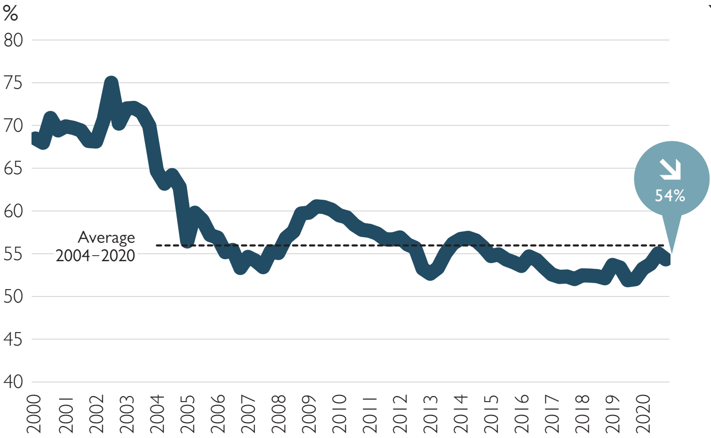
CREDI is based in part on a set of indices illustrating the aggregate change in leverage, duration and cost of debt for the Swedish listed property sector.

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.

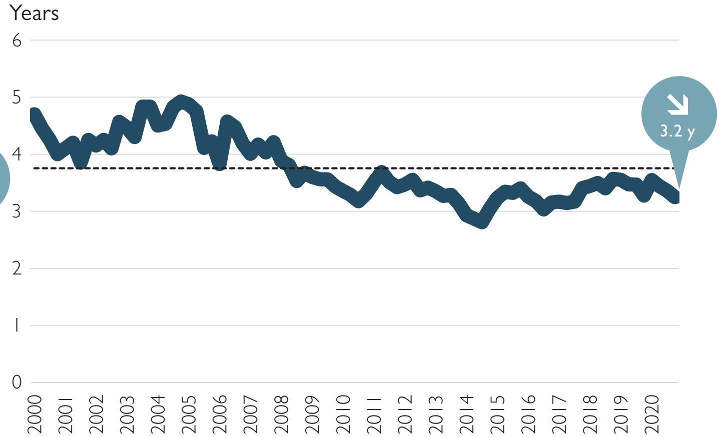
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Loan-to-value[1]



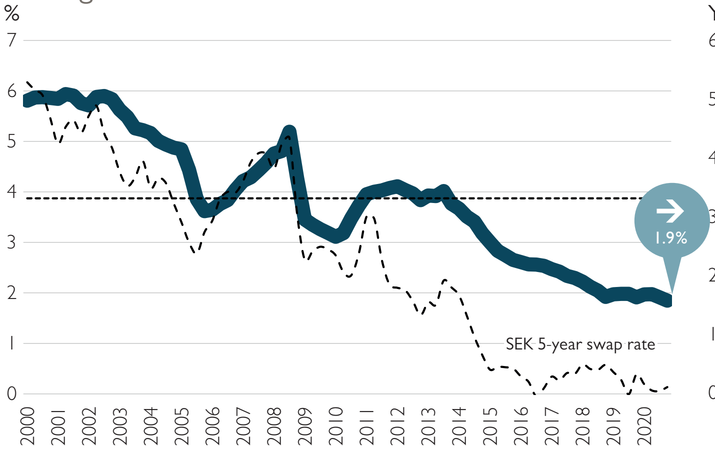
[1] Interest-bearing debt on property, excluding cash, divided by property value.

Fixed credit term[3]



[3] Average maturity referring to interest-bearing debt.

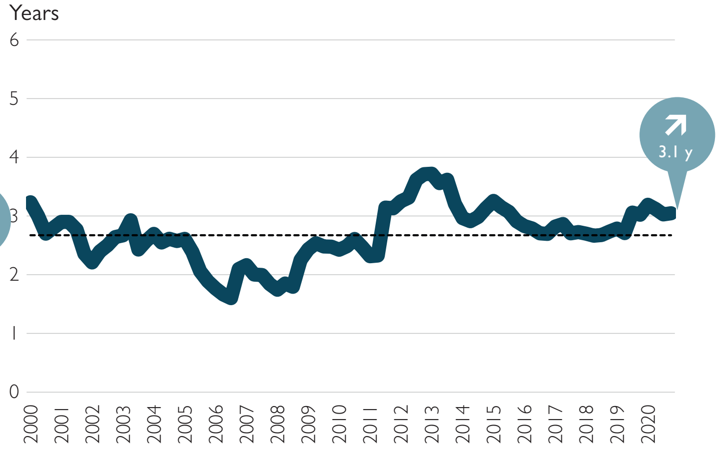
Average interest rate[2]



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

-------- Average 2000–2020

Fixed interest term[4]



[4] Average maturity referring to interest-bearing debt.

Bank Debt

The banks' aggregate lending towards the real estate was more or less unchanged in the fourth quarter of 2020. However, the CREDI Survey signals a clear increase in bank appetite to finance real estate in the first quarter of 2021.

The aggregate amount of bank lending has remained fairly stable. There was a rapid increase in bank lending in March and April in 2020 following the turbulence in the corporate bond market. Since April however the level of bank loans has plateaued. There was even a small decrease in December as the banks optimised their balance sheets before year end. This could pave the way for increased bank lending in 2021, and the CREDI Survey indicates increased supply of bank financing.

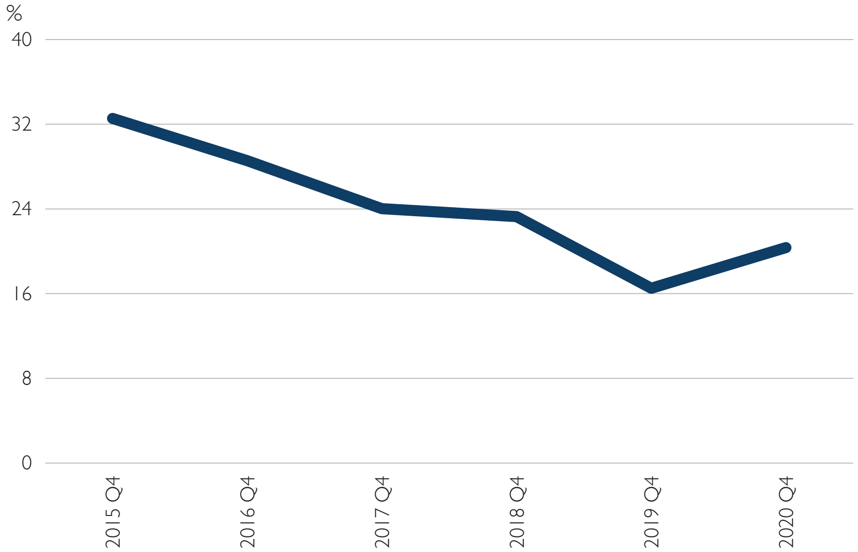
Short-term debt has started to increase again, probably indicating a gradual return to the commercial paper market rather than any restriction on long-term borrowing.

The level of secured debt has started to decrease again after the significant trend shift during the spring when levels of secured debt increased, although the aggregate level of secured debt was still higher at the end of 2020 compared to the end of 2019. The changes in secured debt are a mirror image of the increase in unsecured bond debt during the period.

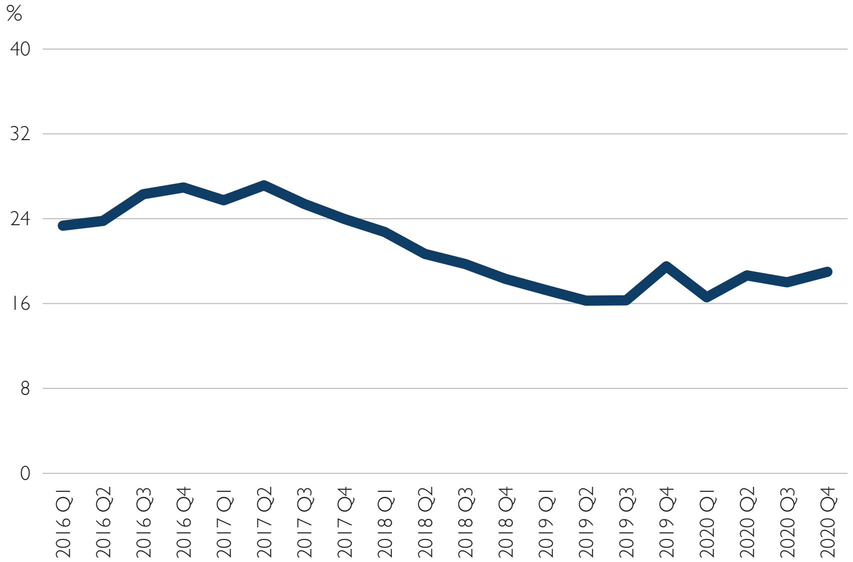
LEVEL OF SECURED DEBT INCREASED

Level of secured debt increased in 2020 as unsecured bonds were refinanced by secured bank loans, partly reversing the opposite trend of bonds replacing bank loans.

Secured debt to total asset ratio



Short-term debt to total debt ratio



Note: Based on publicly available data collected from the financial reports published by Swedish listed property companies.

Bonds

Higher interest rates in the sovereign debt market have not yet affected credit spreads in the SEK and Euro bond markets for Swedish real estate corporates.

Bond credit spreads improved steadily after the worst market turmoil in March until early November, at which point credit spreads started to increase again for borrowers with BBB-rating or below. A-rated companies were however not affected by the slight change in market sentiment and remained at similar levels compared to before the pandemic.

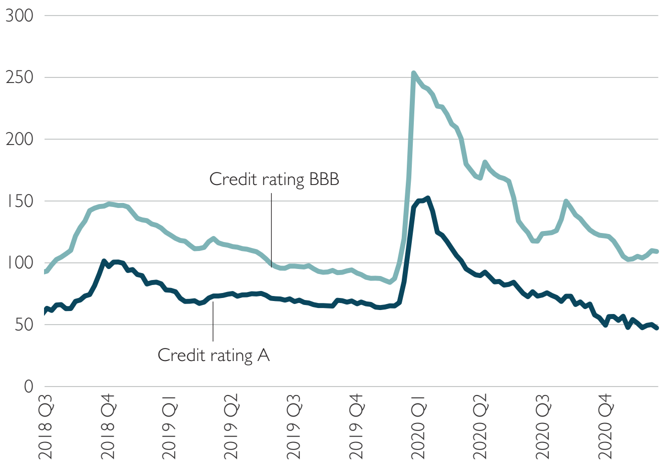
In December bond credit spreads resumed a downward trajectory until the end of January and have been fairly unchanged since.

There has been a bit more drama in SEK swap markets where swap rates started to increase in February after being more or less unchanged from the spring of 2020 and throughout last year. The 5-year swap rate has now increased from 0.1 per cent to 0.3 per cent, creating a corresponding increase in net borrowing for the real estate sector.

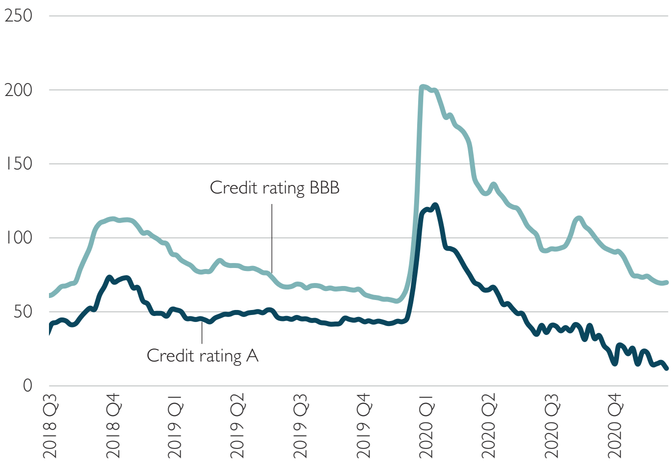
Volumes of net issuance was relatively low in the last quarter of 2020 and the limited amount of new supply coming to market can partly explain the continued improvement in credit spreads.

BACK TO PRE-PANDEMIC LEVELS
Bond credit spreads are back below pre-pandemic levels following fiscal and monetary policy by central banks.

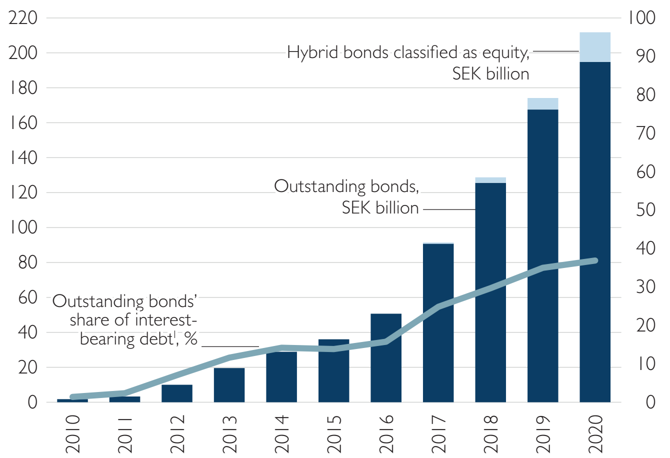
5-year bond credit spreads
Basis points



3-year bond credit spreads
Basis points

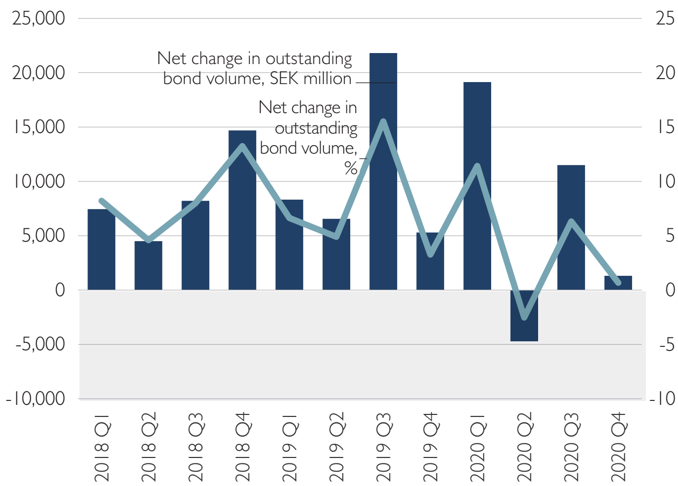


Outstanding bonds
SEK billion / Per cent



[1] Excluding hybrid bonds classified as equity.
Note. Property companies on Nasdaq Stockholm Main Market.

Change in outstanding volume of bonds
SEK million / Per cent

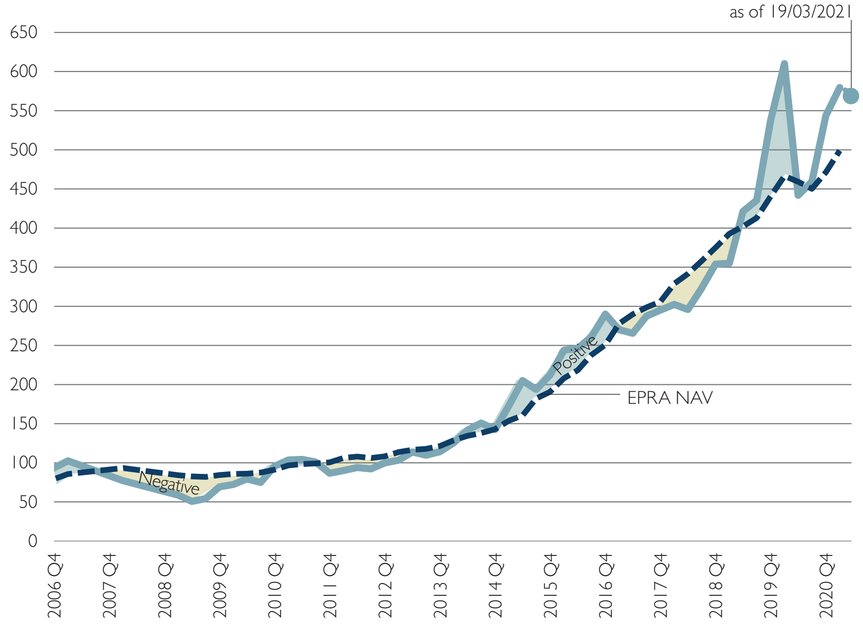


Common shares

The market for property-related shares remains stable while underlying book values pick-up suggesting slightly lower premium.

Premium or discount – market capitalisation as share of EPRA NAV

SEK billion

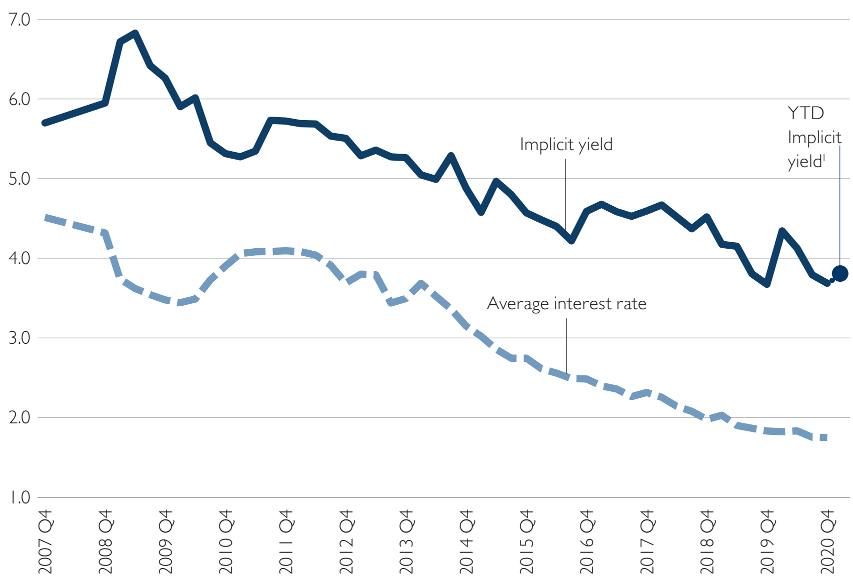


Note. Property companies on Nasdaq Stockholm Main Market.

The listed market for property-related shares on the Nasdaq Stockholm Main Market continued on the previous quarter rebound as aggregated market capitalisation increased from SEK 544 billion to SEK 579 billion. Since then, the aggregated market capitalisation has reverted slightly to SEK 568 billion as of 19/3/2021. Premium was recorded at 16 per cent in the last quarter and around 13.8 per cent as of 19/3/2021. Thus, premium has decreased since the December issue of CREDI where premium was recorded around 20 per cent. While market capitalisation has increased, the underlying book values have increased faster which explains the lower premium.

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

Per cent



[1] Market values 19/3/2021 and Q4 2020 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.

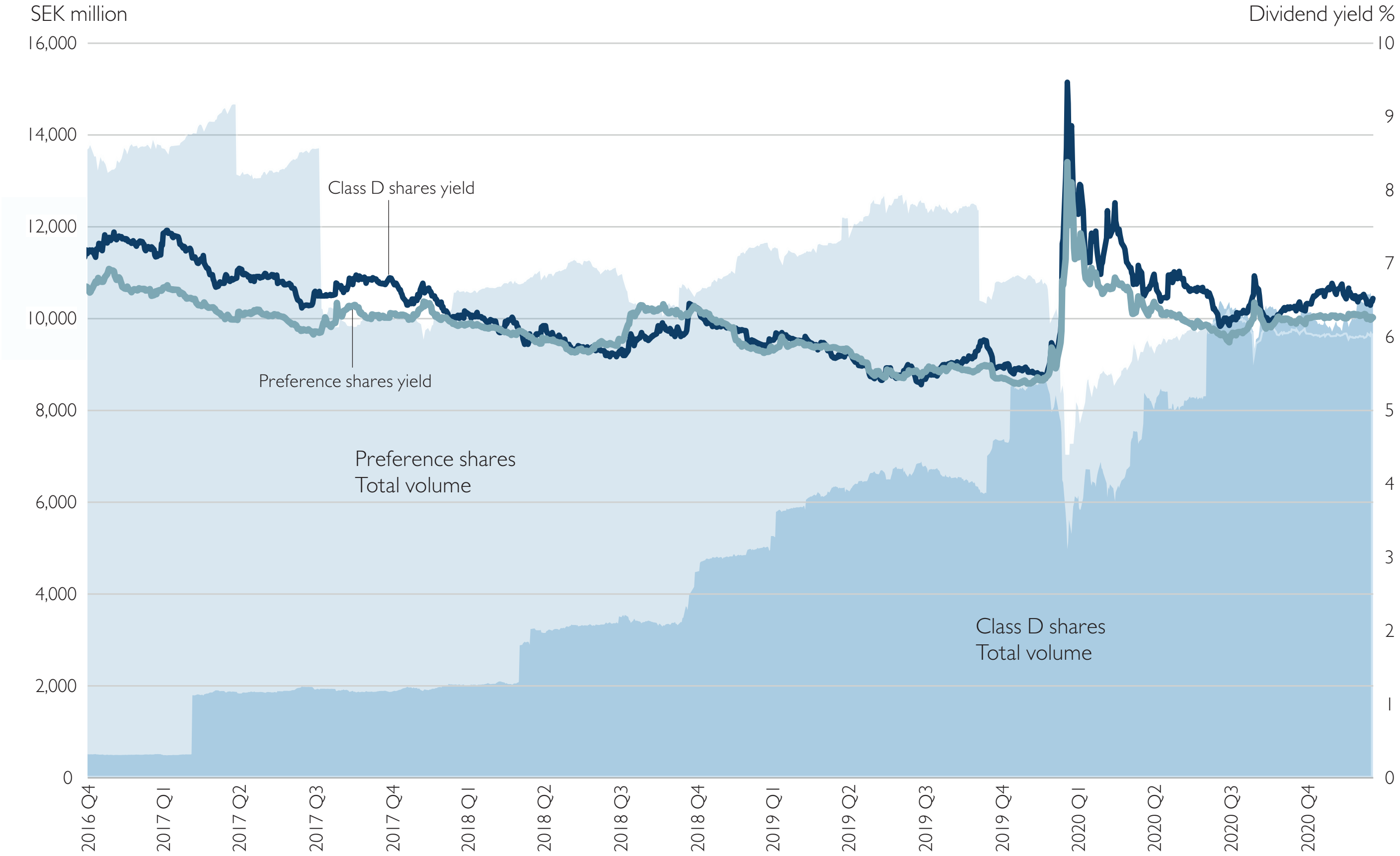
Implicit yields remain around 3.7 per cent as aggregated net operating income moved in tandem with aggregated market capitalisation. The spread between the average interest rate and implicit yield is currently around 200 basis points, in line with the average spread of around 215 basis points in the last five years. Historically, the spread varies from quarter to quarter as implicit yields are rather volatile during market spikes while average interest rates move more slowly. Conclusively, interest rates are expected to remain low in the near term while the spread between implicit yields and average interest rate remains in line with historical valuations.

Source: Catella, annual reports, Nasdaq.

Alternatives

The preference for class D common shares continues as Sagax announces redemption of all preference shares while SBB concludes last day of trading for their preference shares.

Historical yield and volume – alternative equity shares



The secondary market for property-related alternative equity shares remained stable during the fourth quarter and average dividend yields for both preference shares and class D common shares were recorded at 6.25 per cent and 6.5 per cent respectively as of 19/3/2021. Thus, the yield spread between the two classes of shares has increased somewhat to around 25 basis points which is slightly higher than the three-year average of around 13 basis points.

Looking at the graph, we can see that the total volume of outstanding class D common shares went above the total volume for preference shares in the summer of 2020. The trend with favouring class D shares has further continued as Sagax on 3/2/2021 announced a redemption of all outstanding preference shares which was accepted on the Extraordinary General Meeting on 19/3/2021. The purpose for the redemption is simplifying their capital structure and the redemption will occur around 12/4/2021. In total, around SEK 587 million worth of preference shares will be redeemed by Sagax. Interestingly, Sagax first issued their preference share in 2006 (the first among the current property companies) and they were first with introducing the class D common share on the Swedish market in 2016.

Continuing the same theme, SBB announced on 19/3/2021 that the last day of trading for their outstanding preference shares would be on 21/4/2021. Also, SBB has been active by issuing around 20 million class D common shares divided in two separate occasions on 23/12/2020 and on 1/3/2021. As previously stated, class D common shares remain the more attractive source of financing due to the increasing importance of credit ratings and the difference in equity/debt classifications between preference shares and class D common shares by credit rating agencies.

Catella's view through the looking glass

The property market is now standing in a cross road. Whether or not the Western economies will end up in 1970s stagflation (with higher inflation but over time low economic growth) is too early to say for sure, but all warning signs are really there. If that scenario plays, capital will flow to all types of real assets (like property).

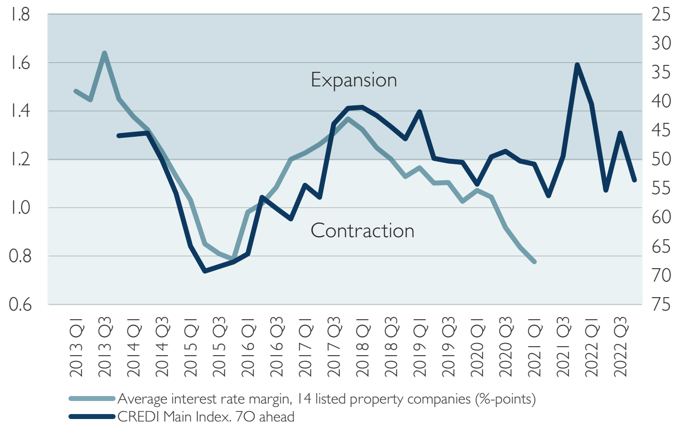
Catella recently made a survey among our key domestic clients regarding what macroeconomic scenario that is most likely for the coming five years. Around 60 per cent of the respondents believed in a low interest-rate scenario for the coming 2–3 years. Almost 90 per cent of the respondents also believe that either residential rental properties, logistics/industrial properties or public properties will be the best performing property segment in 2021. These property segments have really benefitted from the declining long-term real interest rates and the strong consensus view of low interest rates for long. As a result, the capital flow into the segments has been absolutely massive during the last 12 months. The result has been falling interest rate margins for the property companies, portfolio premiums and massive yield compressions within these segments.

However, just as the market consensus has settled, there has been a major shift in the macro environment. Investors expect economic growth to roar back from the spring and for the rest of 2021, propelled by the massive combination of fiscal and monetary stimuli (mainly in the US). The major central banks have reassured markets at multiple occasions that they will keep on stimulating the economy a good way into the recovery, even if inflation overshoots the targets. When governments emit massive amounts of debt simultaneously as the central banks mop up this amount of liquidity, it comes very close to actual monetarisation of debt.

As a result of the expected higher GDP growth, both nominal and real interest rates have now started to increase. The recent months' increase in 30-year US inflation linked bond yield (a real interest rate) of more than 40 basis points will be a real game changer for the property market if it is sustained. The global financial markets are starting to become increasingly anxious about how the imminent economic recovery, higher inflation and increasing interest rates will affect asset prices. Although the consensus view among the domestic actors on the Swedish property market is that interest rates will remain low for years to come, the actors on the global financial markets are not that sure.

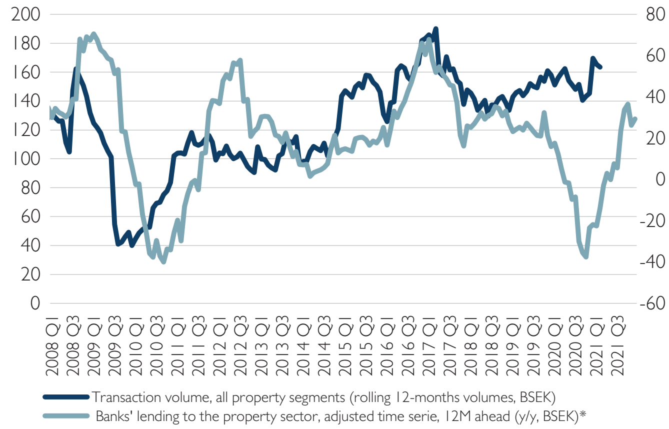
Average interest rate margins and CREDI Main index

Average interest rate margins % points[1] — CREDI Index(Inverted scale)



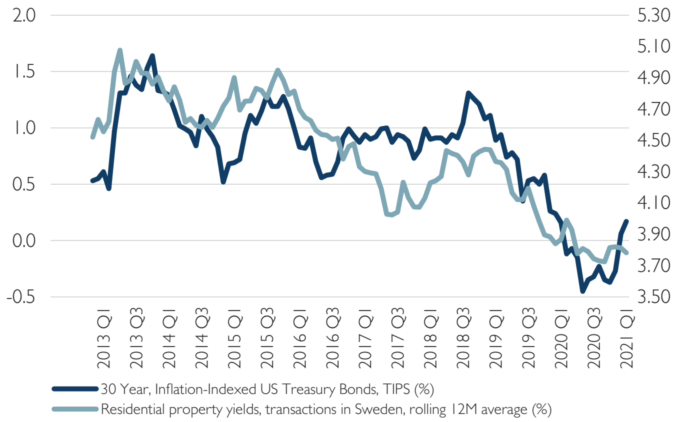
Transaction volume, bank lending commercial property

Transaction volume (BSEK) — Bank lending (y/y, BSEK)[2]



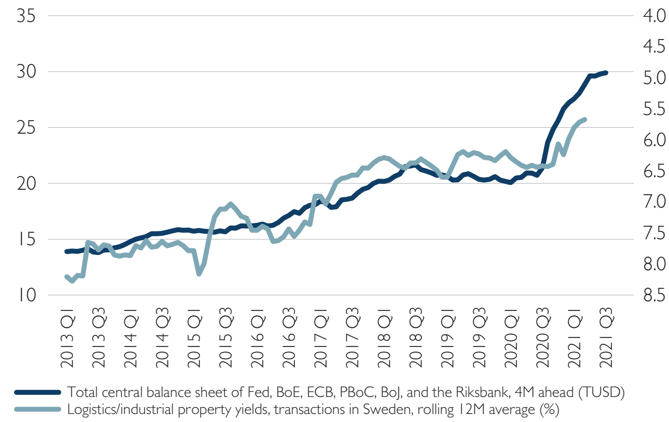
30-year, inflation-indexed US Treasury bonds

Real interest rate (%) — Average residential yield(%)



TUSD[3], yields logistics/industrial property transactions

Balance sheet (TUSD) 4M ahead — Average log./ind. yield (invert. scale, %)



Source: Catella, SEDIS and FactSet

[1] Calculated interest rate margins based on 3-year interest rate/maturity. Average figures for Atrium Ljungberg, Balder, Castellum, Catena, Corem, Diös, Fabege, Fastpartner, Hufvudstaden, Klövern, Kungsleden, Sagax, Wallenstam and Wihlborgs.
[2] The bank lending is adjusted for irregularities and changes in definition in the underlying data.
[3] Total central balance sheet of Fed, BoE, ECB, PBoC, BoJ, and the Riksbank, 4 months ahead.

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CATELLA

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