CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

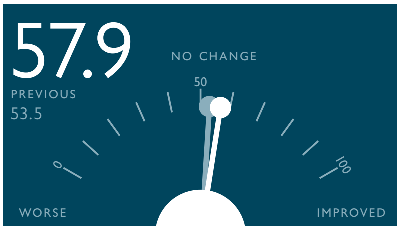
CREDI July 2021

Further improving credit sentiment and historically high equity premiums

In the July issue of CREDI the Main index increases from 53.5 to 57.9 as market participants see improved credit availability and decreased credit margins.

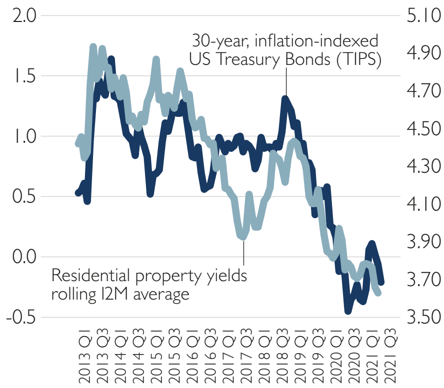
- The CREDI Main index increased further above the 50-mark as banks' view of credit markets became significantly more positive. Corporates remained positive although at a somewhat subdued level according to the index.
- The index specifically points to a significant upswing in the access to credit, lower credit margins and somewhat longer loan maturities.
- Conditions in the bond market was relatively unchanged during the second quarter. However, increased swap rates since March have elevated borrowing costs somewhat.
- Declining real interest rates have propelled the property-related shares on the Nasdaq Main Market as premiums are recorded at a historically high 34.9 per cent.

CREDI Main index



Banks	Corporates
56.3	59.6
46.1	61.0

Real interest rates and average residential property yields



Loan-to-value Q1 average	Interest rate Q1 average	Fixed credit term Q1 average	Fixed interest term Q1 average
→ 54%	→ 1.9%	→ 3.2 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. Subscribe to CREDI at catella.se/CREDI

The CREDI Survey

The July issue of the CREDI Survey suggests a strong credit market as the Main index increases from 53.5 to 57.9 following increased credit availability and lower credit margins.

MAIN INDEX COMPONENTS

In the July issue of CREDI, the Main index remained strong and increased from 53.5 to 57.9 as respondents continued to experience better credit availability and lower credit margins. The increased strength of the Main Index was mainly driven by positive sentiment among banks recorded at 56.3 (46.1).

In aggregate, the Current Situation index is recorded at 60.4 as respondents see better credit availability, lower credit margins and to some extent increased duration.

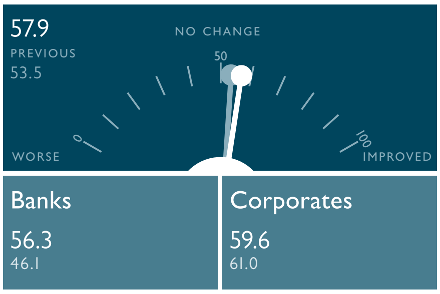
Coming back to the increased sentiment among banks, the banks' Current Situation index recorded at 58.9, however, the Expectation index recorded at a lower 53.6. Similarly to the banks', the corporates' Current Situation index recorded at a high 62.5 and the Expectation index lower at 56.7. This is a common situation when the credit cycle is at or close to the peak (as is currently the case).

However, the combined Expectation index remained strong, above the 50-mark at 55.2.

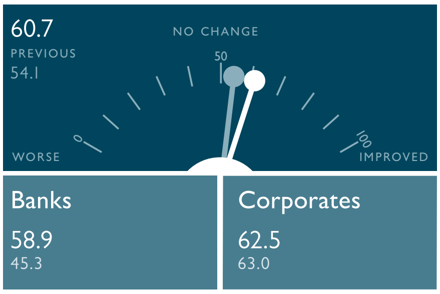
SUB-INDICES

The CREDI Main index is made up of eight underlying sub-indices. According to respondents in the July survey of 2021, credit availability and margins improved significantly and the leverage slightly increased. However, the duration marginally decreased. Notably, improving credit availability and lower 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 and duration.

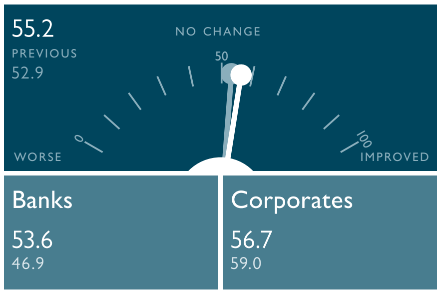
CREDI Main index



Current Situation



Expectation



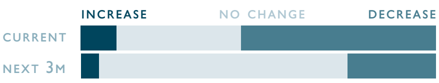
The CREDI sub-indices present survey data question by question. The bars represent the distribution of actual answers per question, separated into the components Current Situation and Expectation for the coming three months.

CREDI Sub-indices

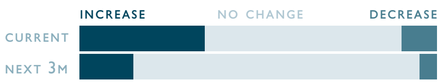
CREDIT AVAILABILITY

LEVERAGE

CREDIT MARGINS



DURATION



ABOUT THE CREDI SURVEY

CREDI is a market sentiment indicator for the Swedish real estate debt 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

Minor to no changes within the CREDI Indices.

During the first quarter of 2021, there were only minor changes within the CREDI Indices as loan-to-value, average interest rate and fixed credit term remained at 54 per cent, 1.9 per cent and 3.2 years respectively. Fixed interest term decreased slightly from 3.1 to 3.0 per cent.

Analysing the average interest rate further, Hufvudstaden lowered theirs by 20 basis points to 1.10 per cent making them together with Diös the two property companies with the lowest average interest rate in the segment. At the same time, Genova increased their average interest rate by 86 basis points to 2.96 per cent. This is arguably due to Genova's issue of green hybrid bonds of SEK 500 million under a framework of a total of SEK 1,250 million in February 2021. The green hybrid bonds have an eternal maturity and run with an interest rate of 3 months STIBOR plus 675 basis points.

ABOUT THE CREDI INDICES

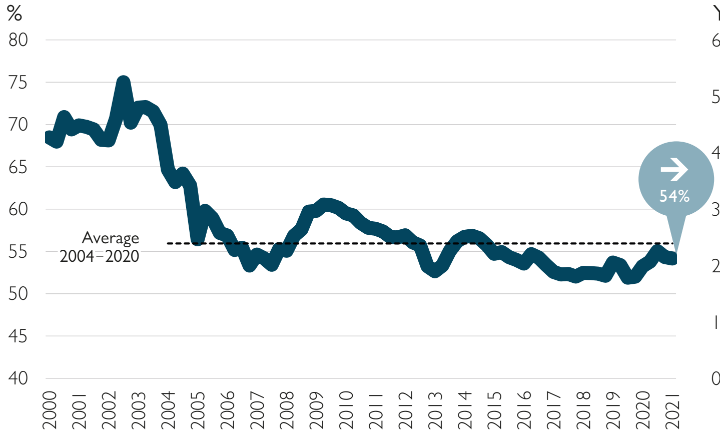
CREDI is based in part on a set of indices illustrating the aggregate change in leverage, duration and cost of debt for the Swedish listed property sector.

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 Q1 2000.

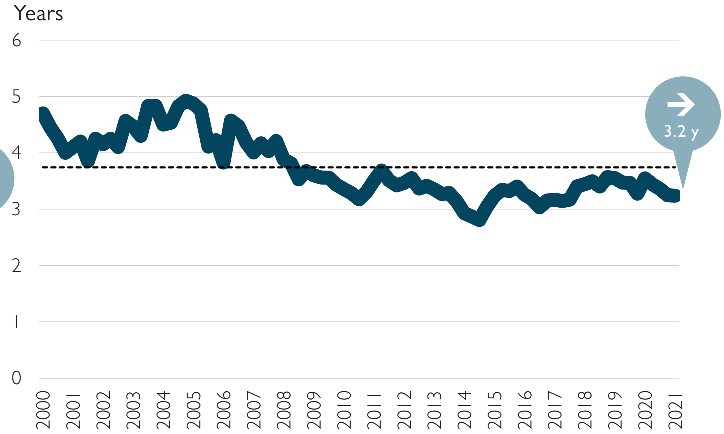
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Loan-to-value[1]



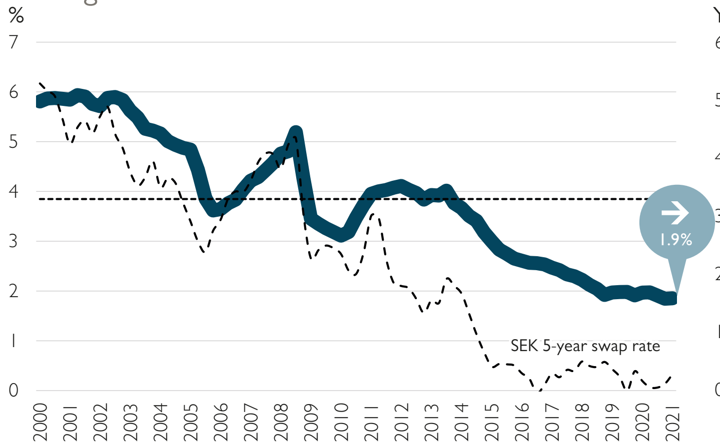
[1] Interest-bearing debt on property, excluding cash, divided by property value.

Fixed credit term[3]



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

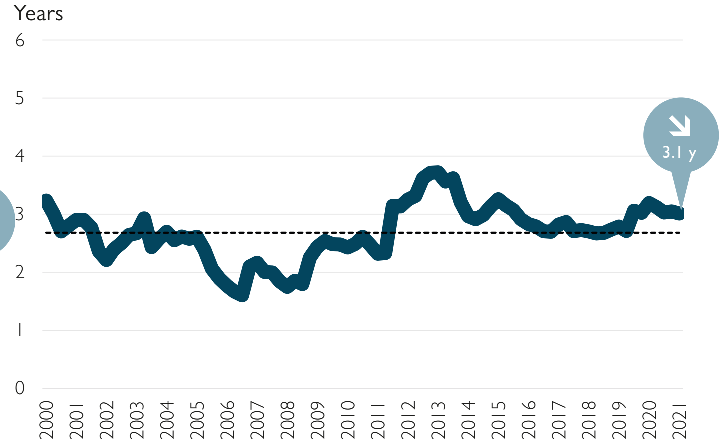
Average interest rate[2]



[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

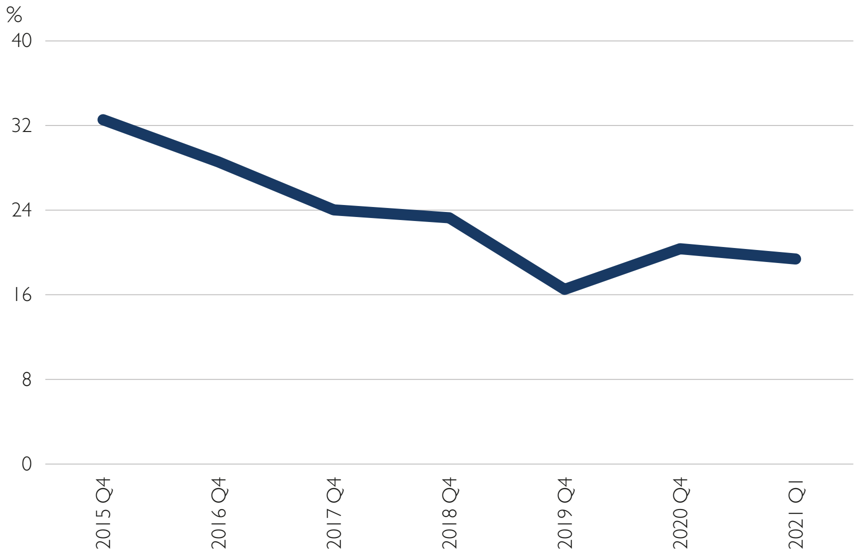
The banks' aggregate lending towards the real estate sector continues to increase, which rimes with the improved levels of the CREDI index.

The aggregate amount of bank lending is trending upwards as higher property prices warrants increased indebtedness.

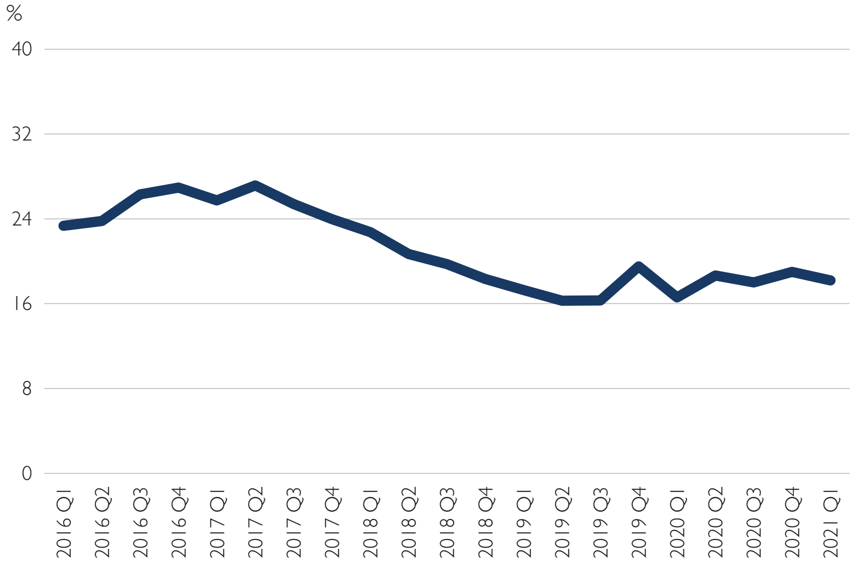
There was a rapid increase in bank lending in March and April in 2020 following the turbulence in the corporate bond market. After April 2020 the level of bank loans towards real estate plateaued. There was even a small decrease in December as the banks optimised their balance sheets before year end. This paved the way for increased bank lending in 2021, and CREDI indicies confirms improved conditions for the supply of bank financing.

The level of secured debt has started to decrease again after the significant trend shift during the spring 2020 when level of secured debt increased. The changes in secured debt is a mirror image of the increase in unsecured bond debt during the period. The level of short term debt, a crucial measure of financial risk for the sector, remains more or less unchanged.

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

Credit spreads remain low in the bond markets for Swedish real estate corporates. Property companies with a focus on offices enjoy as favourable conditions in the bond market as the rest of the property sector despite less benign development in the equity markets.

Bond credit spreads improved steadily after the worst market turmoil in March until early November 2020, 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.

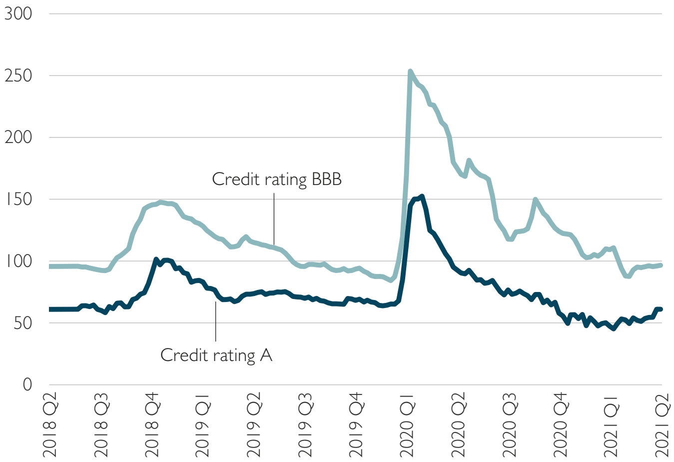
In December bond credit spreads resumed a downward trajectory until the end of January and have been fairly unchanged since. It is notable that credit spreads for property companies focusing on offices remain low despite the equity market's generally unfavourable view of these companies.

There has been a bit more drama in SEK swap market 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 0.4 per cent, creating a corresponding increase in net borrowing for the real estate sector.

Volumes of net bonds issuance increased significantly in Q1 2021.

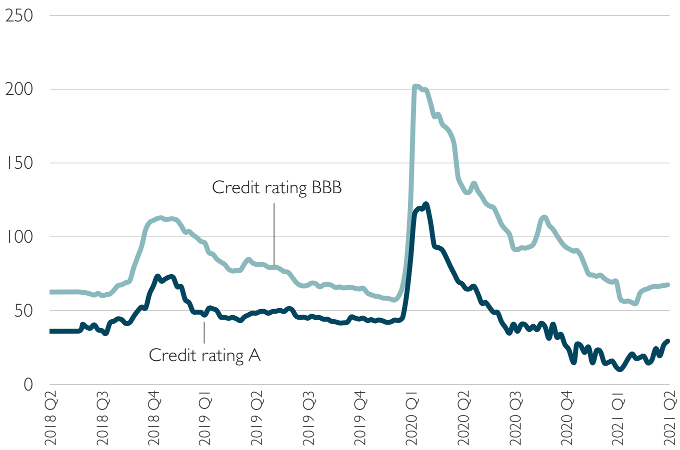
5-year bond credit spreads

Basis points



3-year bond credit spreads

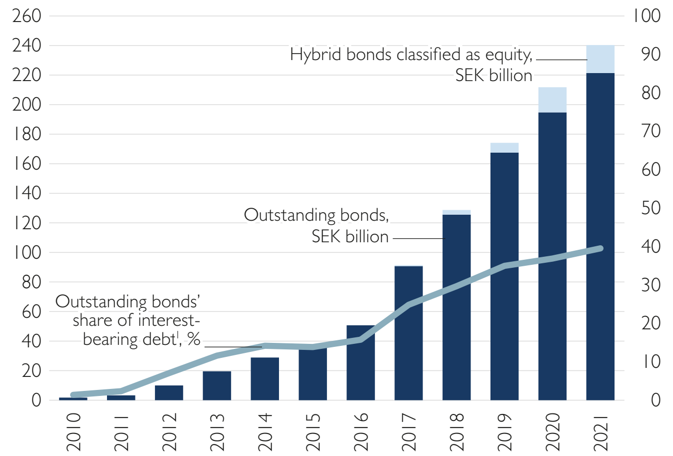
Basis points



Outstanding bonds

SEK billion

Per cent

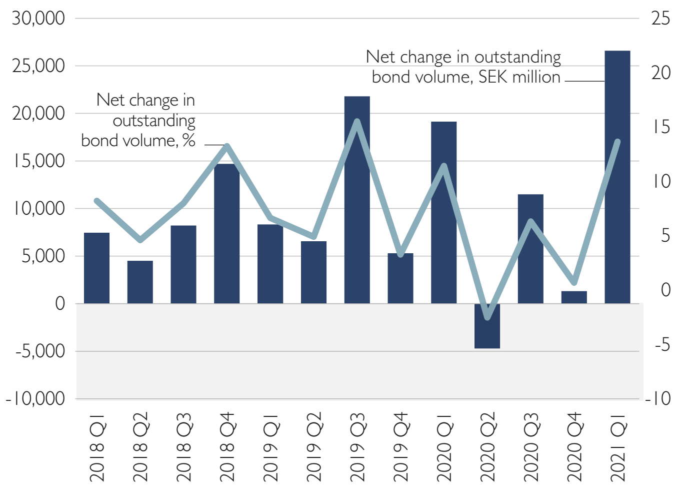


¹Excluding hybrid bonds classified as equity.
Note. Property companies on Nasdaq Stockholm Main Market.

Change in outstanding volume of bonds

SEK million

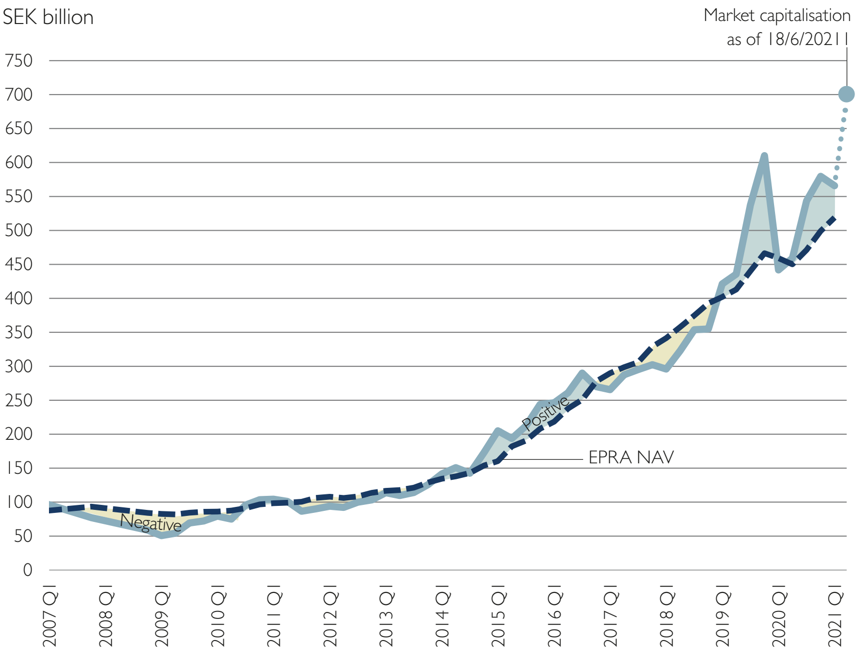
Per cent



Common shares

Th equity prices of the listed property companies have been soaring during recent months on the back of declining real interest rates, with significantly higher premiums as a result.

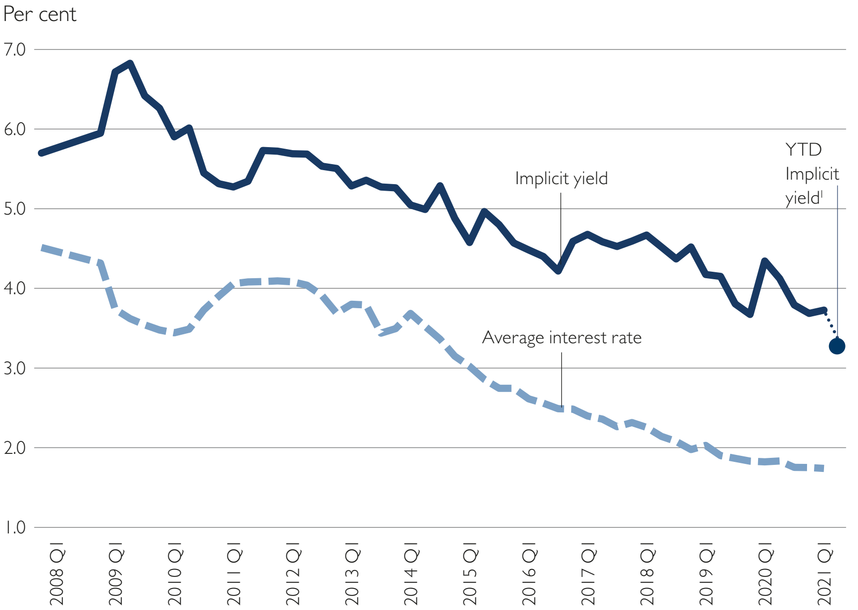
Premium or discount – market capitalisation as share of EPRA NAV



Note. Property companies on Nasdaq Stockholm Main Market.

In the first quarter of 2021, the aggregated market capitalisation for listed property companies on the Nasdaq Stockholm Main Market decreased from SEK 580 billion to SEK 566 billion. However, as of 18/6/2021 the aggregated market capitalisation has soared to SEK 700 billion. Premium was recorded at 9.0 per cent in the previous quarter and around 34.9 per cent as of 18/6/2021. This is a historically high level and is likley a result of the recent months' declining real interest rates.

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



[1] Market values 18/6/2021 and Q1 2021 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.

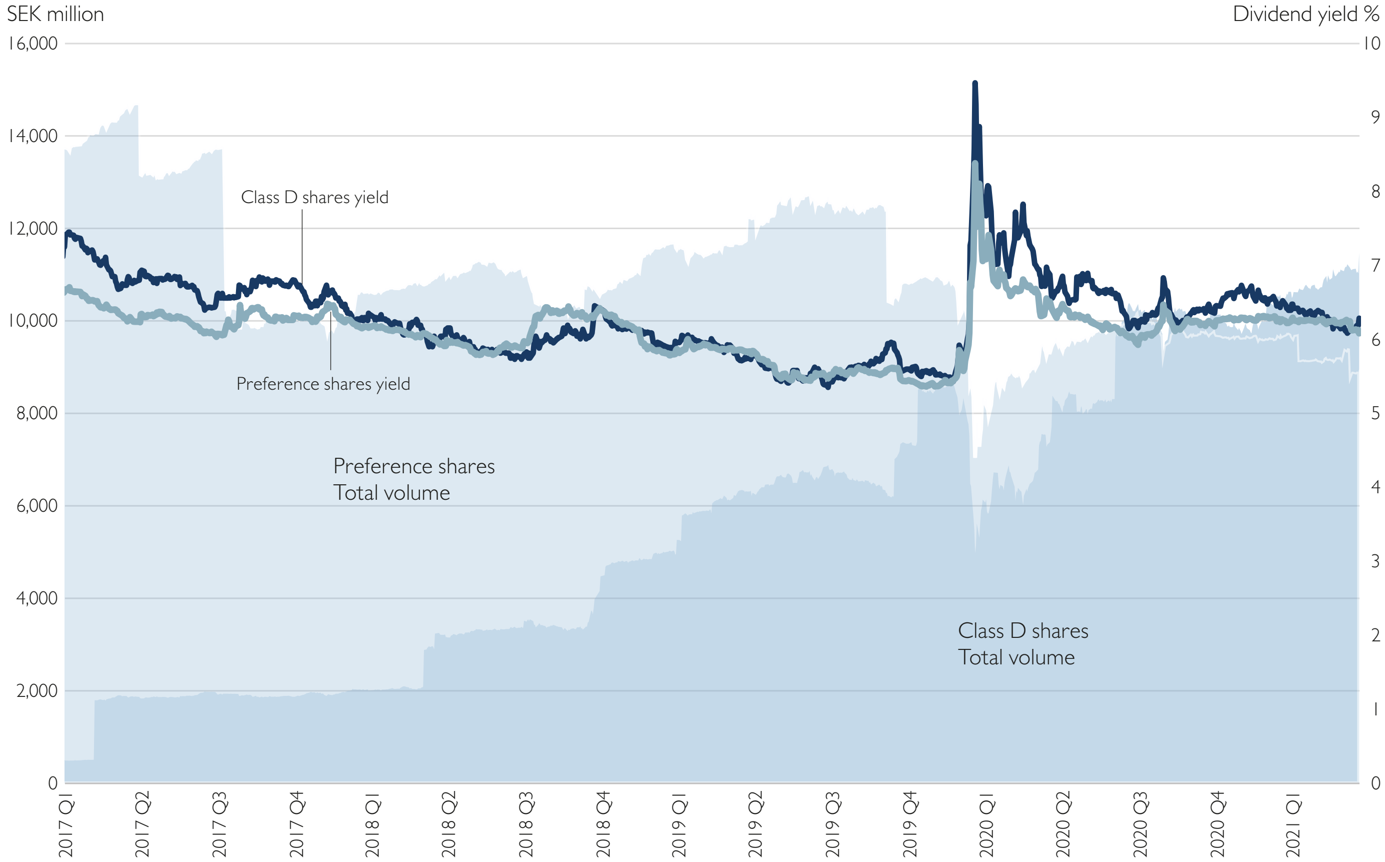
As of 16/6/2021 the implicit yield has dropped to 3.3 per cent following the spike in market capitalisation. This is a 40 basis points drop from the 3.7 per cent during the first quarter. The spread between the average interest rate and implicit yield is currently around 200 basis points, similar to 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.

Source: Catella, annual reports, Nasdaq.

Alternatives

The preference for Class D common shares continues as Sagax delists their preference shares during the second quarter.

Historical yield and volume – alternative equity shares



The secondary market for property-related alternative equity shares remained stable during the first quarter and as of 18/6/2021 the average dividend yields for both preference shares and class D common shares were recorded at 6.1 per cent and 6.3 per cent respectively. Thus, the yield spread between the two classes of shares has increased somewhat to around 20 basis points which is slightly higher than the 3-year average of around 13 basis points.

As described by the graph, the total volume of outstanding Class D common shares went above the total volume for preference shares in the summer of 2020. The trend favouring class D common shares has further continued as Sagax delist all outstanding preference shares. The purpose for the redemption is to simplify their capital structure and for rating purposes. Additionally, Genova Property Group delisted their preference shares in the beginning of June 2021.

A company following the trend of advocating class D common shares over preference shares is Corem. In March 2021 Corem announced the opportunity for their preference share holders to exchange it to class D common shares in a 1:1.12 ratio. Additionally, this has been part of their tender offer to acquire Klövern where Klövern's preference shareholders also have the option to exchange their shares to Corem's class D common shares. According to Corem, the reason for this is to increase financial flexibility and create better conditions for the company to reach an Investment Grade rating.

To conclude, class D common shares remain the more attractive source of alternative equity financing between the two and this is 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 rolling 12-months transaction volume was around SEK 166 billion in mid-June, somewhat below the 2020 full-year volume of around SEK 170 billion (excluding indirect transactions).

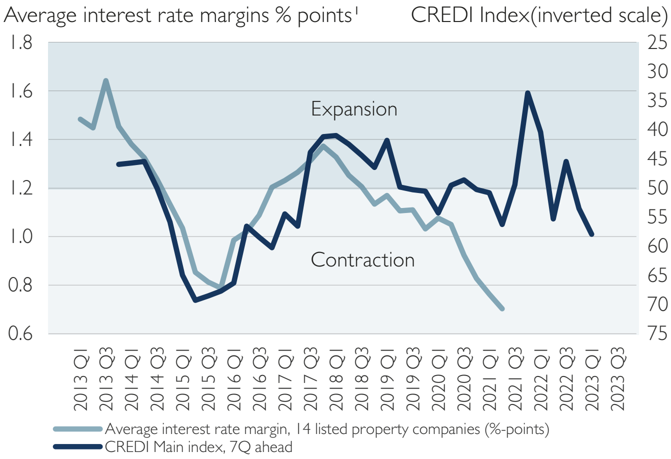
The listed property companies have had an extremely strong development over the last months and the average equity price for 39 of the largest listed property companies has recovered all ground they lost against the OMX Stockholm 30 during the first quarter (the equity prices are up over 20 per cent in average in Q2). This development peaked in mid-June when the Fed announces a slightly more hawkish stance than expected by the markets.

One reason behind the strong performance of the listed property companies is that the real interest rate has been in a downtrend since late March. Based on the strong equity price development of the companies focusing on residential/public properties (up over 30 per cent in Q2), as well as the logistics/industrial and mix commercial properties (up 18–25 per cent in Q2), there will continue to be a major inflow of capital into these segments on the property market for at least six months ahead. Over the last year there has been a strong correlation between the long-term interest rate (the 30-year US inflation linked bond yield) and Swedish property yields (and especially residential property yields).

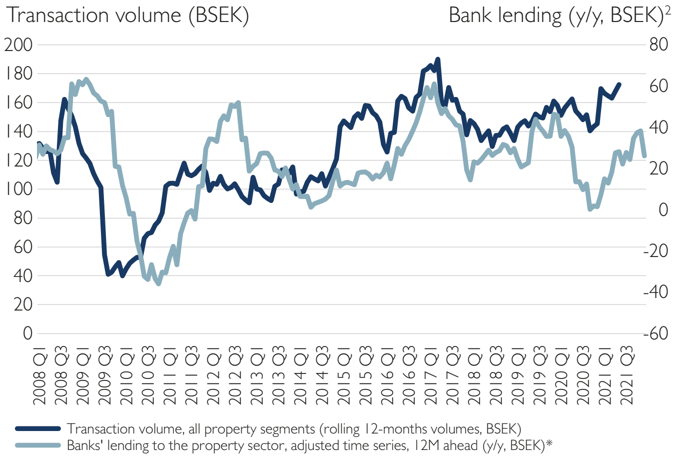
Catella recently made a survey among our key domestic clients regarding the most likely macro scenario. Around 60 per cent of the respondents believed in a low inflation/interest rate scenario for the coming 2–3 years. Almost 90 per cent of the respondents believe that either residential rental properties, logistics/industrial properties or public properties will be the best performing property segment in 2021.

This view on the future trajectory of inflation is, however, not shared by Catella in the medium term. Catella main scenario includes stagflation, where inflation/long-term interest rates enter a long-term uptrend while growth remains low. If that scenario plays, capital will flow to all types of real assets like commodities, infrastructure, and property.

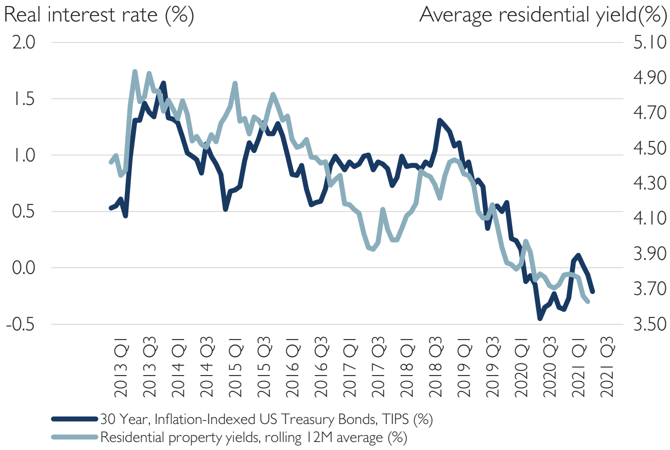
Average interest rate margins and CREDI Main index



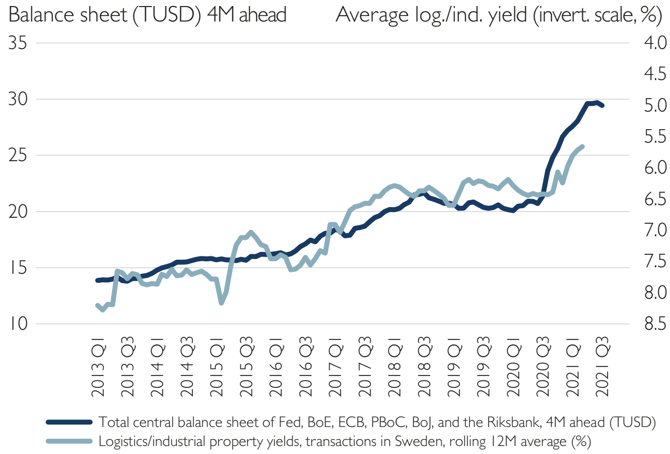
Transaction volume, bank lending commercial property



30-year, inflation-indexed US Treasury bonds



TUSD[3], yields logistics/industrial property transactions



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.

Contacts

Jacob Bruzelius
Head of Debt Advisory
Direct: +46 8 463 32 67
SMS: +46 73 390 09 80
jacob.bruzelius@catella.se

Arvid Lindqvist
Head of Research
Direct: +46 8 463 33 04
SMS: +46 72 537 17 45
arvid.lindqvist@catella.se

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