CREDI June 2022

CREDI index points to an abysmal development in the market for real estate backed bank loans

In the June issue of CREDI the Main index decreases from 44.6 to 27.5, which constitutes an unprecedented low level of the index. The poor performance in the bank market is well aligned with deteriorating developments in the unsecured bond market.

- The CREDI Main index registered its lowest reading ever at 27.5 while at the same time registering the biggest ever drop in the index from one quarter to the next.

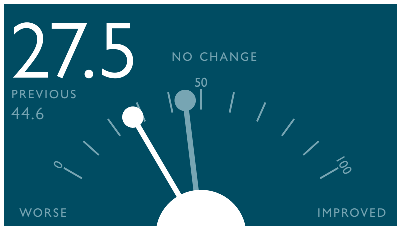
- The Q2 CREDI index is also unusual in that the subindex of current situation is as low as expectation in three months time (27.7 versus 27.2).

- Swap rates have increased substantially since last CREDI in both SEK and EUR markets. In Q1 Riksbanken stated that they would not raise rates until 2024, however, in April they raised it by 0.25 per cent and the market is pricing in a 0.5 per cent increase in the interest rate in June.

- Bond credit margins have continued to increase, especially since the end of April, further underpinning our call in October that the tide had turned in the credit markets.

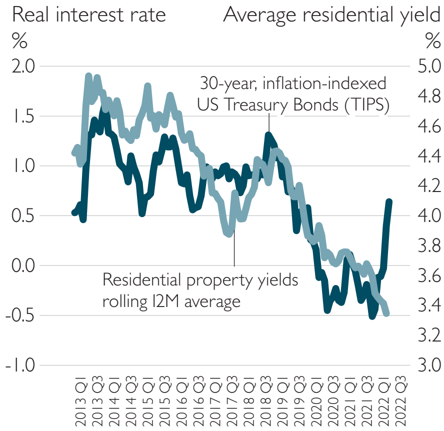
- The transaction volume on the Swedish property market has been in an upward trend since mid-2018 and reached a historic peak in May of just over SEK 249 billion (rolling 12-month volume). Transaction volumes and the number of deals will likely fall back during the second half of 2022.

CREDI Main index



Banks	Corporates
17.7	37.2
39.3	50.0

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
→ 52%	↗ 1.8%	→ 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

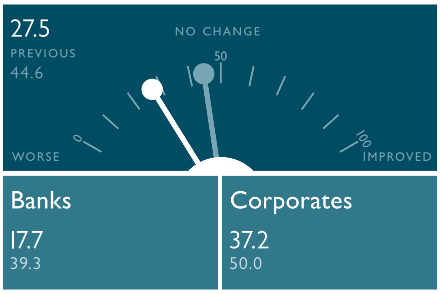
The CREDI Main index registered its lowest reading ever at 27.5 while at the same time registering the biggest ever drop in the index from one quarter to the next. Higher credit margins and decreasing availability of credit are the main drivers for the falling index.

In the June issue of CREDI, the Main index declined from 44.6 to 27.5. Current expectations dropped the sharpest from 49.5 (50.0 is neutral) to 27.7, while expectations also dropped markedly from 39.8 to 27.2. Both banks and borrowers view the current situation more or less the same as expectations about the future. However, banks are much more negative at 17.7 compared to borrowers at 37.2. Banks always respond more defensively to the CREDI survey, but the difference between banks and borrowers tend to be 5–15 points rather than circa 20 points. The low reading from the banks may portend even lower levels of the CREDI index going forward.

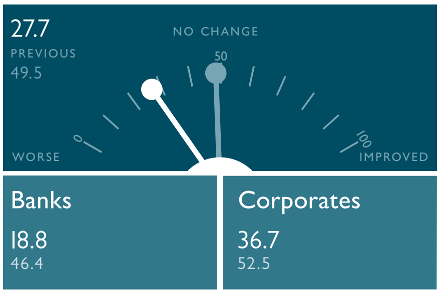
The largest contributor to the rapid drop in the CREDI index relates to the markets firm belief that credit margins have increased and will increase further. The second most impact on the index was market participants' view that the availability of debt has decreased. Both these readings mirrors the developments in the bond market.

A number of market participants viewed LTV level in the bank debt market to have decreased. Least impact on the index in this edition was the subindex of loan duration which seems to have shortened, but only slightly.

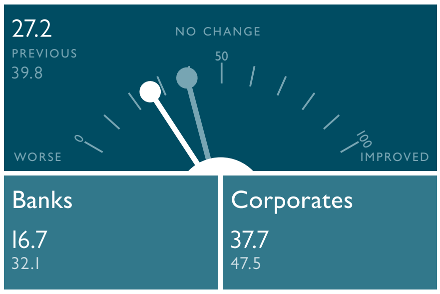
CREDI Main index



Current Situation



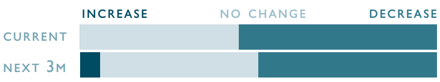
Expectation



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

There have been minor changes within the CREDI Indices during the recent quarters/months. Although the average interest rate increased marginally.

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.

LISTED SECTOR Q1 AVERAGE LOAN-TO-VALUE[1]

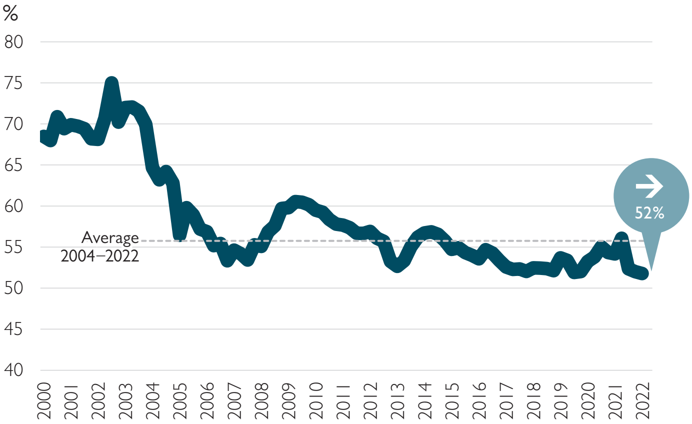
During the first quarter of 2022, there were only minor changes within the CREDI Indices as loan-to-value remained at 52 per cent. The loan-to-value level remain fairly stable as the appraisal value of the property portfolios was not affected by the market turmoil in the same way as listed financial assets.

LISTED SECTOR Q1 AVERAGE INTEREST RATE

The average interest increased to 1.8 per cent, increasing approximately 6 basis points compared to the previous period. Currently, Heba and Diös both have industry-leading average interest rates at 1.05 and 1.10 per cent respectively. Genova remained as the company with the most expensive financing at 2.67 per cent. Fixed credit term and fixed interest term remained stable at 3.2 years and 3 years.

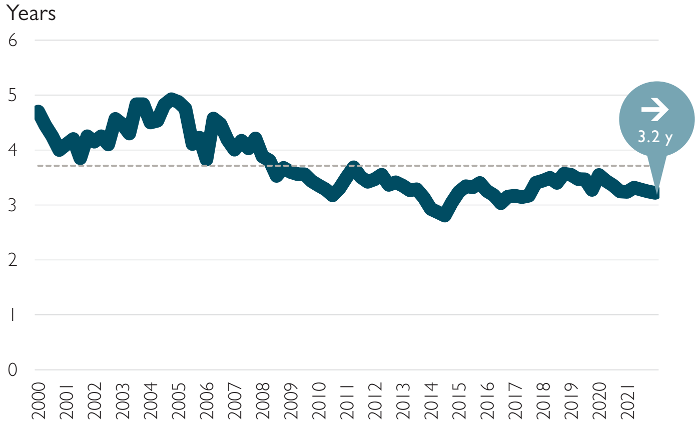
Overall, there have been minor changes within the CREDI Indices during the recent quarters/months.

Loan-to-value[1]



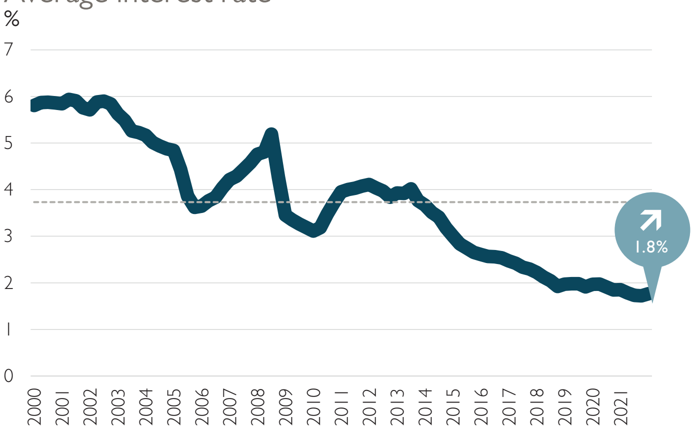
[1] Interest-bearing debt on property, excluding cash, divided by property value.

Fixed credit term[3]



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

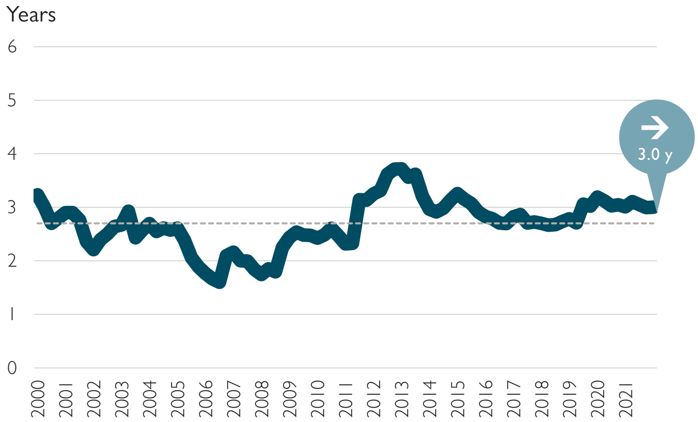
Average interest rate[2]



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

-------- Average 2000–2022

Fixed interest term[4]



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

Debt market

Our October prediction that we would see a turn of the tide in interest and credit markets have so far proven correct. The trend of increasing credit margins and increasing swap rates have accelerated since the previous CREDI, which was finalized just before the war in Ukraine began.

The increases in the interest rate swap markets have been dramatic since February. The 3 year and 5 year rates in the SEK market have increased with 1.2 per cent to 2.2 per cent and 2.4 per cent respectively. The shorter rates for 18 and 24 months have increased even more with 1.4 per cent leaving the 18 months rate at 1.8 per cent, which should be compared with STIBOR 3M being as low as 0.1 per cent only a few months back. The market is now pricing in that the 3 year swap rate will be approximately 2.6 per cent in one year's time.

The effect of the elevated levels in the swap market is compounded by increases in the interest cost elsewhere. Margins in the bank loans market have evidently increased as the CREDI index clearly indicates. The anecdotal evidence from Catella Corporate Finances' ongoing mandates in the property transaction market does however not support quite as negative view of the debt markets as the index indicates.

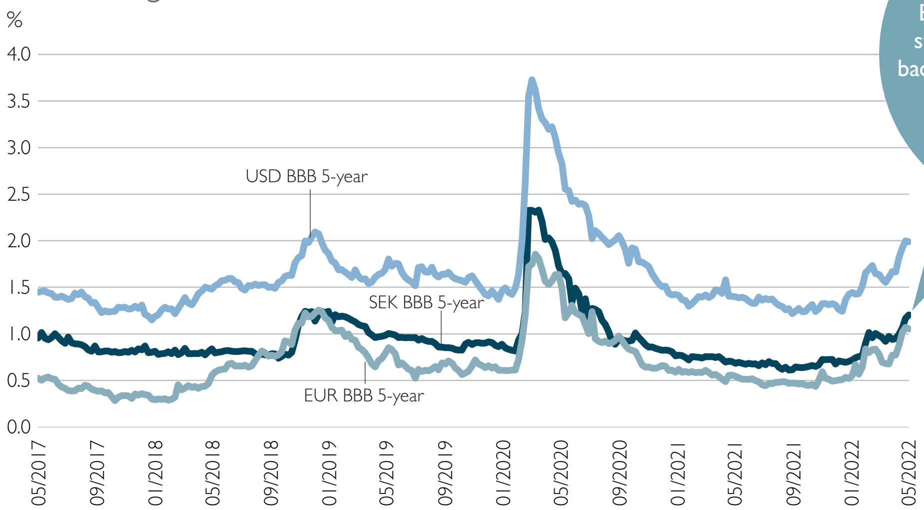
The shift in the capital markets is however much in line with the outcome of CREDI index. Volumes of new bond issues have decreased markedly compared to last year from February onwards. Bond issues from Swedish real estate companies in the euro market has more or less ceased altogether, which is concerning given how reliant some of Sweden´s larger corporates have become on this market. Issuing volume in the SEK market is down as well. In the last couple of weeks the real estate issuers backed by the AP funds have all been able to tap the bond market in large volumes. The listed real estate issuers with BBB ratings have however not been able to access the bond market to the same degree.

In early 2021 the credit spreads for BBB issuers (within real estate) for five year duration were around 100 basis points. In April 2022 the same issuers were selling bonds at around 200 basis points for the same duration, while presently these bonds are traded at around 250–300 basis points.

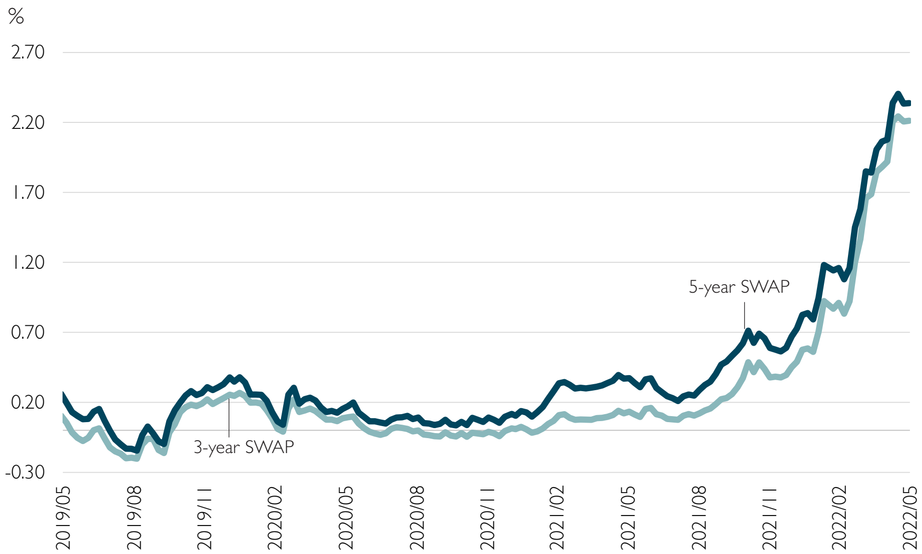
The increase in credit margins is a global phenomenon and connected to the reversal of the big central banks QE. In the coming autmn Catella expects that the credit margin spreads will increase and that they are likely to continue to increase as QE is in all likelihood history.

INCREASE
Bond credit spreads have started to increase on the back of reduced QE from the central banks

Credit margin



3- and 5-year SWAP rates



Common shares

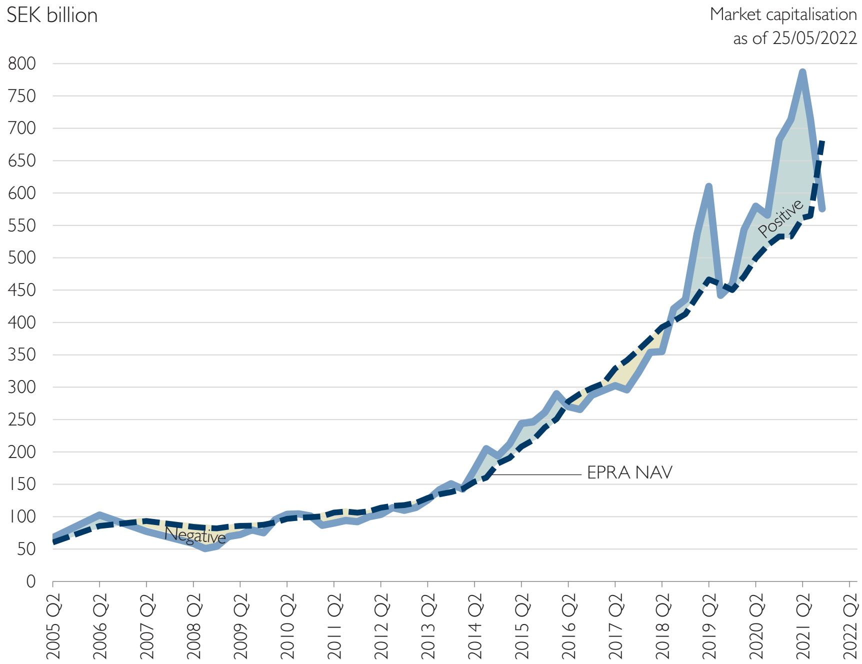
The market for property-related shares has sharply declined and the market capitalisation towards EPRA NAV is now trading at a discount of 15 per cent to NAV.

During the first quarter of 2022 the market capitalisation of the property-related shares on the Nasdaq Stockholm Main Market remained high at SEK 714 billion, up almost 26 per cent since the first quarter of 2021. During the same period, EPRA NAV increased by 21 per cent to SEK 680 billion. However, the property-related shares on the Nasdaq Stockholm Main Market experienced a correction phase and the market capitalisation fell by approximately 20 per cent, to SEK 576 billion (as of 25/05/2022). Notably, many of the property-related shares reached an all time high before the end of the fourth quarter, hence, the decline was arguably more severe than portrayed by the quarter-to-quarter perspective. The decline of the market capitalisation has, among other things, resulted in the largest discount to NAV recorded in over twelve years. As of 25/05/2022 the property-related shares listed on the Nasdaq Stockholm Main Market traded at discount to NAV of 15.5 per cent.

As a result of the market capitalisation declining the implicit yields increased further to 3.6 per cent, corresponding to an increase of almost 75 basis points compared to the last quarter of 2021. As both financing and building materials have and are expected to become more expensive, the market capitalisation might further decrease, increasing the implicit yield even further.

Premium or discount – market capitalisation as share of EPRA NAV

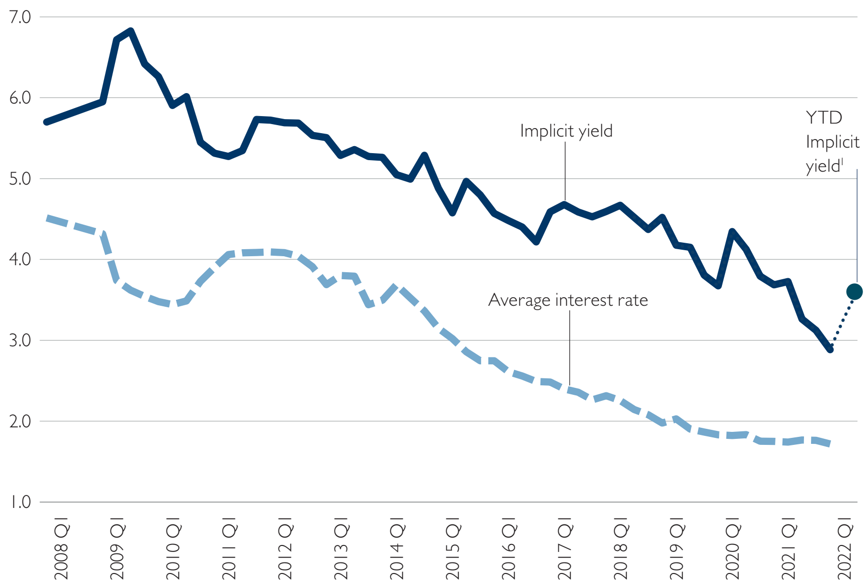
SEK billion



Note. Property companies on Nasdaq Stockholm Main Market.

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

Per cent



[1] Market values 25/05/2022 and Q1 2022 EPRA NAV.

Note. Property companies on Nasdaq Stockholm Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent. Market values 25/05/2022 and Q1 2022 EPRA NAV.

Alternatives

The trend of favoring class D common shares continues. The secondary market for property-related alternative equity shares decreased during the beginning of 2022.

As of 25/05/2022 the average dividend yields for both preference shares and Class D common shares were recorded at 6.6 and 7.3 per cent respectively, both increasing. Thus, the yield spread between the two classes' shares has increased to around 65 basis points which is higher than the three-year average of around 20 basis points.

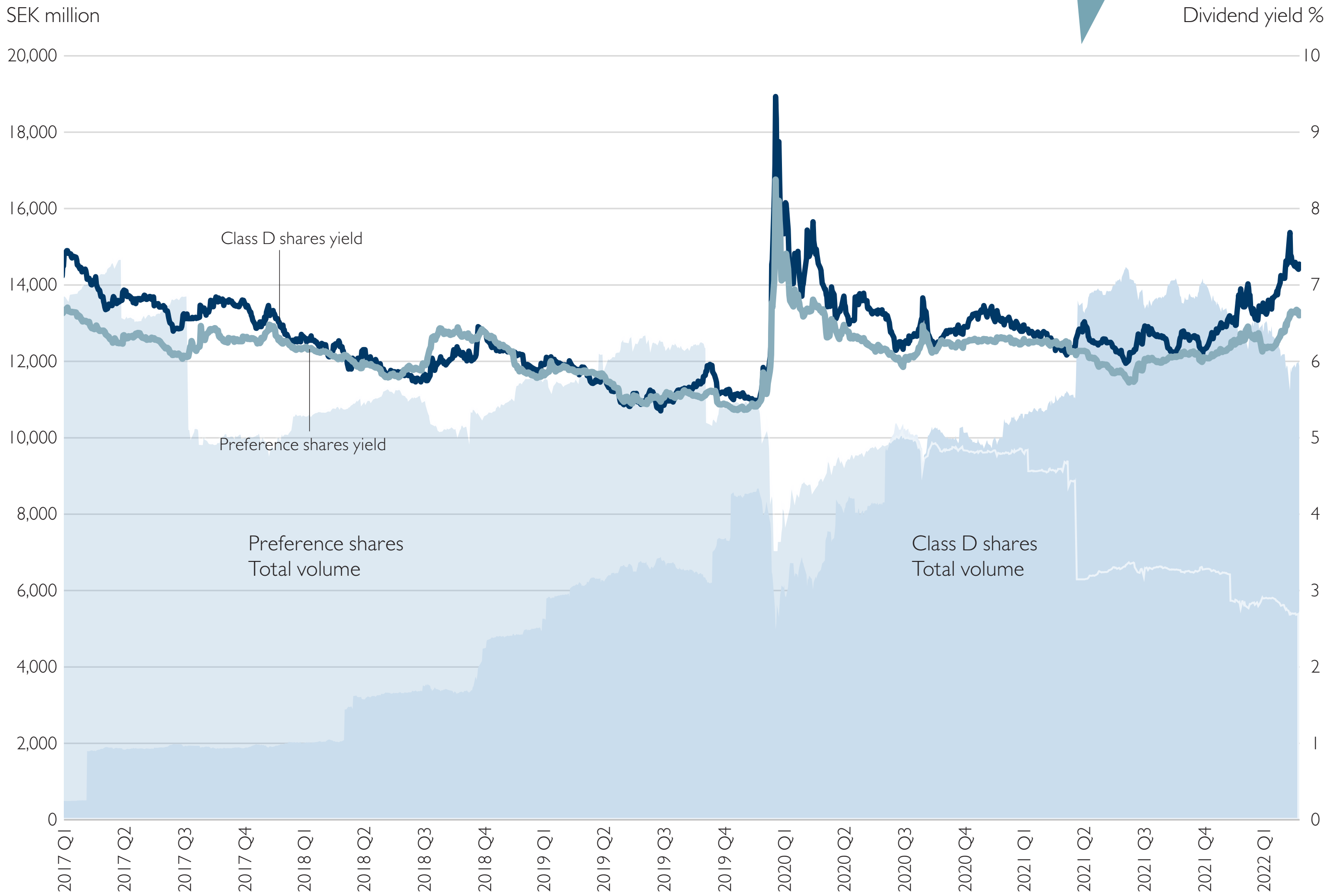
As described by the graph, the Class D common shares has become increasingly popular over preference shares. The trend of favoring Class D common shares intensified as FastPartner delisted all outstanding preference shares as a part of FastPartners tender offer. According to FastPartner, the reason for this is to optimise their balance sheet. Fastpartner initially issued their preference shares in 2013, at the time preference shares were fully regarded as equity by rating agencies. However, as Fastpartner received an Investment Grade rating in 2021, the rating agencies considered preference shares to be equally part equity and debt and thus the Board of Fastpartner made the assessment that the preference share has played out its role as a form of financing.

By the end of March 2022, Corem announced an exchange offer to its preference shareholders. The exchange offer includes all preference shares in Corem. Corem offers 1.12 ordinary shares of class D in Corem for each preference share in Corem that is redeemed. According to Corem, the reason why only preference shareholders are offered redemption of shares is to enable increased financial flexibility. An increased number of new ordinary shares of class D creates better conditions for Corem to, over time, reach an Investment Grade.

CLASS D COMMON SHARES MORE POPULAR

The trend of favouring Class D common shares intensified as Klövern delisted all their preference shares

Historical yield and volume – alternative equity shares



Source: Catella, annual reports, Nasdaq.

Catella's view through the looking glass

The transaction volume on the Swedish property market has been in an uptrend since mid-2018 and reached a historic peak in May of just over SEK 249 billion (rolling 12-month volume). Transaction volumes and the number of deals will likely fall back during the second half of 2022.

For years, Catella has seen a stagflation scenario as the most likely macroeconomic development in the medium term. Higher consumer prices, monetary tightening and lower real incomes for households are likely dragging down the Swedish economy into a mild recession in 2023. However, lower economic growth will slow down the CPI inflation rate too. If the economy slows down too much though, there is a high risk that the debt load collapses, and we end up in a global recession. Economic growth will therefore be seen as more important for central banks than fighting inflation. Catella's main scenario is that short-term interest rates will increase fast during coming quarters as the Riksbank increases the repo rate to around 1.25 per cent in late 2022. Long-term nominal interest rates have increased extremely fast during recent months. They are, however, now temporarily falling back in line with the slowing economic growth but will follow a long-term increasing trend during coming years.

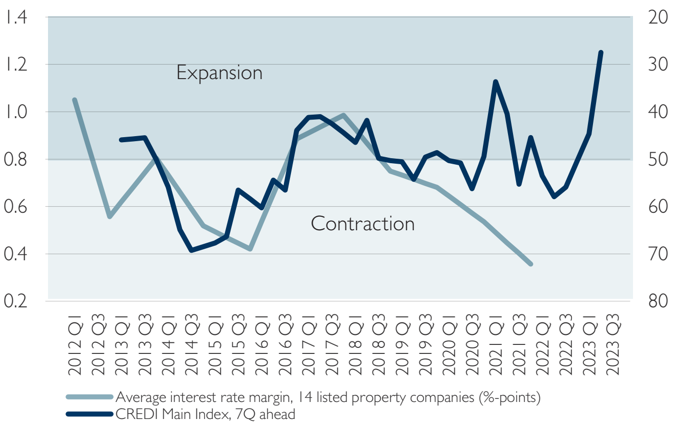
The sentiments on the credit market have deteriorated significantly during the last quarter. Less central bank stimuli, lower economic growth and more risk averse investors are now producing higher credit spreads for the property companies. Although, central banks will likely not be able to reduce credit spreads as they did during the pandemic due to high inflation, they will not let credit spreads increase too much as it would jeopardise the financial stability.

On the property transaction market buyers are facing high spot market interest rates/credit margins, while sellers have capital and interest rate maturities of around three years in average. This makes it difficult for buyers and sellers to meet, therefore decreasing the liquidity. However, Catella expects central banks to tighten too little and too late to rein in inflation. As a result, long-term inflation expectations will increase, and long-term real interest rates will decline below the zero mark again, a rather good macro environment for real assets like property.

There are major differences between the property segments' effectiveness in a stagflation environment. Segments with low yield levels like residential and public properties in major/regional cities, as well as prime offices and logistics, will be hit hard by the higher financing costs. While property with higher yield levels, limited new supply and market rents that follow CPI inflation (like industrial/logistics, public, grocery store and big-box retail), will perform better.

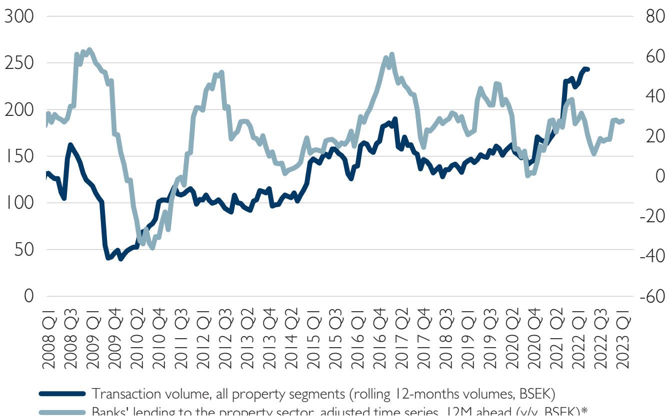
Average interest rate margins and CREDI Main index

Average interest rate margins % points[1] CREDI index(inverted scale)



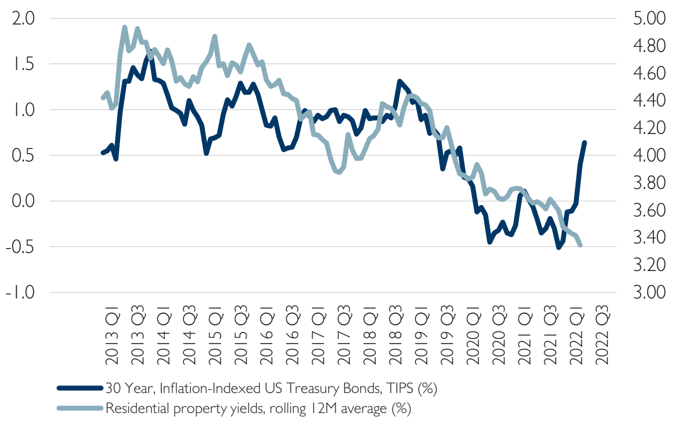
Transaction volume, bank lending commercial property

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



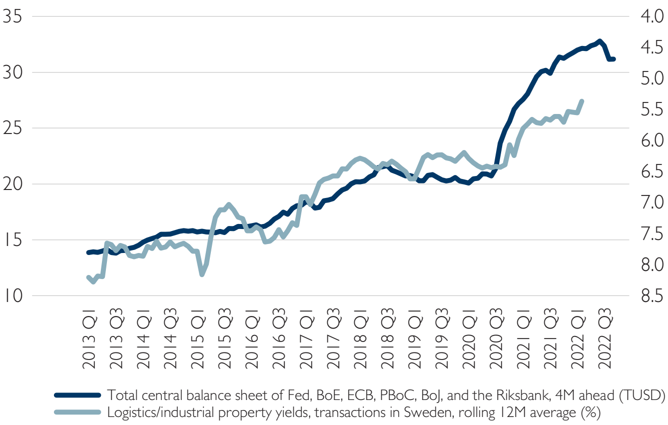
Real interest rates and residential yields

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



Central bank balance sheet[3] and logistics yields

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

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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