CREDI September 2016

Sweden's property sector has benefited from the Brexit-effect

In the months following the Brexit vote, central banks around the world have continued to support the financial markets. This has resulted in a reinvigorated Swedish stock market, in particular for the property sector. However, although the CREDI Main index has improved, the property debt financing market is still in contraction.

The June issue of CREDI discussed some of the instability that the United Kingdom had experienced in anticipation of the European Union membership referendum. Although the likelihood of the leave-vote winning was deemed overwhelmingly small, markets around the world woke up to the news that the United Kingdom had voted to leave the European Union. This caused several stock markets to crash – including the Swedish stock market.

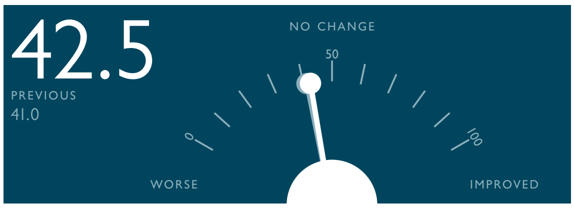
An unanticipated macroeconomic event that causes a country's stock market to crash usually has a negative effect on access to financing. However, since Brexit the long-term interest rates have plummeted and the CREDI Main index has improved, although the property debt financing market is still in contraction. This is also reflected in the listed property companies' quarterly reports, as average loan-to-value has increased while the average interest rate has decreased slightly.

Furthermore, the market capitalization of property companies has soared since the Brexit vote and is now at an all-time high. In the second quarter of 2016, the market capitalization of the property companies on Nasdaq OMX Nordic Main Market increased by 6.6 per cent, and property stocks have increased even further during the third quarter. In other words, the Swedish property market hardly appears to have been negatively affected by the Brexit vote at all.

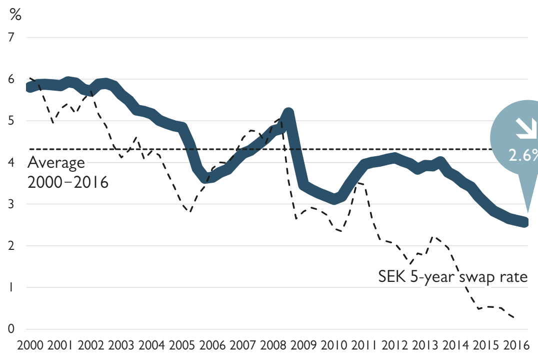
In addition to increasing their loan-to-value, the listed property companies have issued a record SEK 6.1 billion in bonds in the second quarter of 2016. The total volume of outstanding bonds is now SEK 45.2 billion, which is nearly 15 per cent of the companies' interest-bearing debt.

Finally, Sagax has announced that they are introducing a Class D common share, which is a new type of security that is set to challenge the preference share as property companies' favourite source of equity.

CREDI Main index

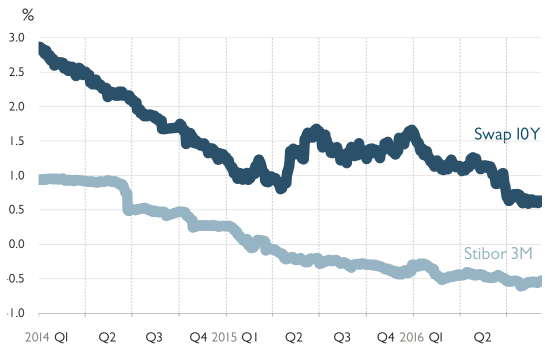


CREDI Indices – Q2 Average interest rate*



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

Swedish key interest rates, 2014–2016



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 increased from 41.0 to 42.5 in the September survey. Property companies and banks believe that access to financing has improved, but that the debt financing market is still in contraction. However, their view on the future development has worsened as the Expectation index fell by 3.7 index points, from 46.7 to 43.0.

Main index components

The CREDI Main index has seen a slight improvement from 41.0 to 42.5, which means that property companies and banks believe that access to financing has become better in the second quarter of 2016, but that the property debt financing market is still in contraction. Accordingly, this is the fourth consecutive quarter where the Main index is below the 50.0 turning point.

Looking at the underlying Current Situation and Expectation indices, it is apparent that the surveyed respondents are increasingly of the belief that access to financing on the Swedish property market is stabilizing. The Current Situation index has gone up from 35.4 to 41.9 while the Expectation index has fallen from 46.7 to 43.0. As such, the spread between the Current Situation index and the Expectation index has decreased to just 1.1 index points, which is noticeably lower than in the June survey.

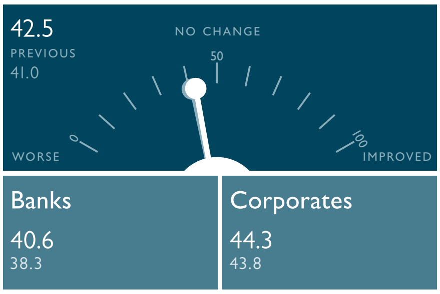
Since the June survey, property companies and banks have reached similar conclusions on how access to financing has changed over the past three months as well as how they believe it will change in the future. This has resulted in an even stronger consensus between property companies and banks than in the June survey, with a spread of just 3.7 index points. This is the smallest spread between property companies and banks in the CREDI Main index in more than two years, and the second smallest spread since the CREDI surveys were first conducted in May 2012.

Sub-indices

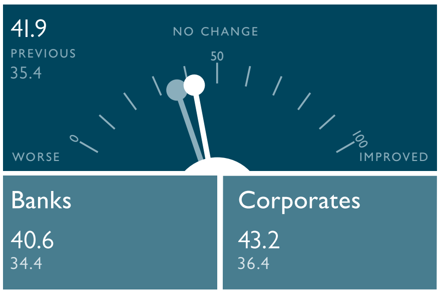
As the CREDI Main index has changed marginally, there were only minor changes in the majority of the CREDI sub-indices. However, the Current Credit Margins sub-index has improved drastically, bouncing back from a particularly low level in the June survey. As such, the sub-index increased from a miniscule 12.2 index points in June to 41.5 index points in the September survey, which is by far the most important reason why both the Current Situation index and the Main index improved.

Nevertheless, the Credit Margins sub-indices are also a main reason as to why the Main index has remained below the 50.0 turning point.

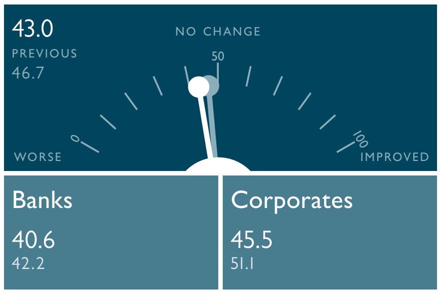
CREDI Main index



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.

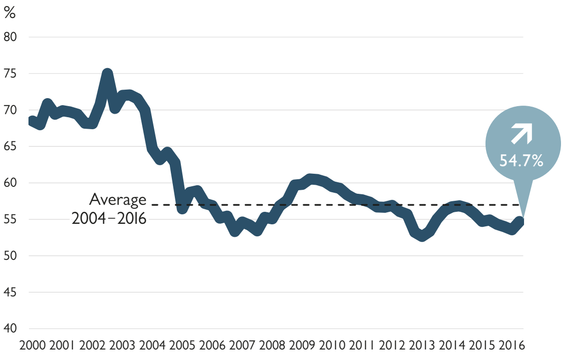
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 trend of falling interest rates, fixed credit terms and fixed interest terms continued in the second quarter of 2016. However, the average loan-to-value of the listed property sector has increased by 1.1 pecentage points – the largest increase in two and a half years – moving towards the historical average of 57 per cent.

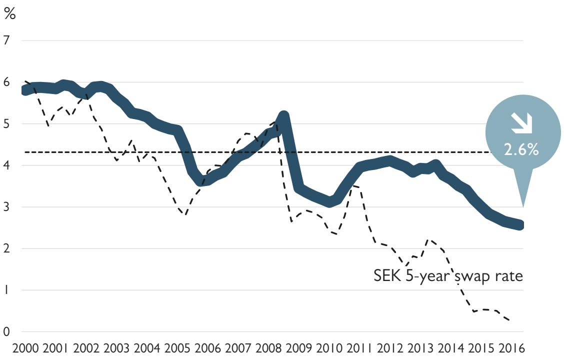
Listed sector Q2 average loan-to-value[1]



During the second quarter of 2016, property value increased by 10 per cent while the amount of interest-bearing debt increased by 12 per cent. As such, the listed property companies' average loan-to-value increased by 1.1 percentage points to 54.7 per cent. The increase is to a great extent attributable to Castellum's aquisition of Norrporten. Castellum accounts for approximately half of the listed companies' SEK 33 billion increase in interest-bearing debt, and half of the listed companies' SEK 52 billion increase in property value.

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

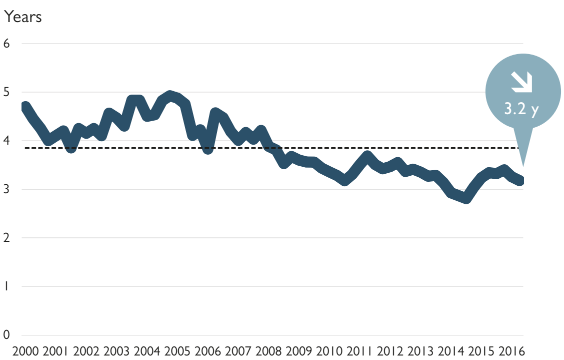
Listed sector Q2 average interest rate[2]



The average interest rate among the surveyed property companies has continued to fall, albeit only by four basis points. However, even though the average interest rate among the surveyed property companies is at its lowest point in the history of CREDI, far below the historical average of 4.3 per cent, the average interest rate could possibly fall even lower considering the interest rate for new loans. For example, there are several listed property companies with average interest rates around the two per cent mark.

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

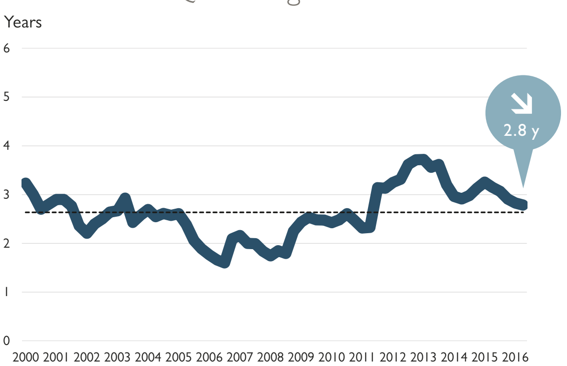
Listed sector Q2 average fixed credit term[3]



The average fixed credit term decreased from 3.3 years in Q1 2016 to 3.2 years in Q2 2016, making this the second consecutive quarter with reduced credit terms. The falling average fixed credit term could suggest that the listed sector does not expect the refinancing risk to increase in the near future. Indeed, only five of the twenty surveyed property companies extended their fixed credit terms in the second quarter of 2016. The average fixed credit term of 3.2 years is still well below the historical average of 3.9 years.

3 Average maturity referring to interest-bearing debt.

Listed sector Q2 average fixed interest term[4]



-------- Average 2000–2016

In the second quarter of 2016, the average fixed interest term decreased from 2.83 years to 2.79 years, pushing it slightly further towards the historical average of 2.6 years. This is the fourth consecutive quarter with falling fixed interest terms, suggesting that the listed sector does not expect interest rates to go up in the near future. However, this is the smallest shift in the average fixed interest term since the first quarter of 2013, which might be an indication that the property companies' fixed interest term is stabilizing around the historical average of 2.6 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.

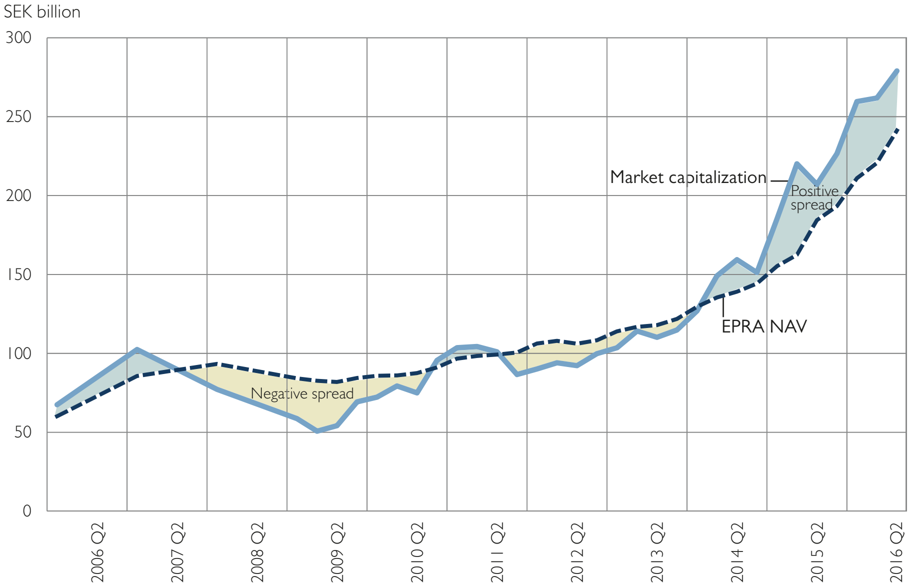
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

CREDI – Common shares

In the second quarter of 2016, property companies became increasingly popular on Nasdaq OMX Nordic Main Market, increasing their market capitalization by 6.6 per cent. In addition, since the end of the second quarter the property companies' market capitalization has increased even further. However, the companies' EPRA NAV has increased at a higher rate than market capitalization, resulting in a slightly lower market premium during the second quarter of 2016.

The market capitalization of the property companies on Nasdaq OMX Nordic Main Market increased from SEK 262 billion in the first quarter of 2016 to SEK 279 billion in the second quarter of 2016, which constitutes an increase by 6.6 per cent. This increase notwithstanding, the combined EPRA NAV of the property companies increased by 9.3 per cent in the second quarter of 2016. Accordingly, market premiums have been contracting in the property sector for the second consecutive quarter, from 23.1 per cent at the end of 2015 to 15.6 per cent at the end of the second quarter of 2016. Nevertheless, given that the market capitalization of property companies on Nasdaq OMX Nordic Main Market has gone up further in the third quarter of 2016, it is possible that market premiums will have increased by the end of the third quarter.

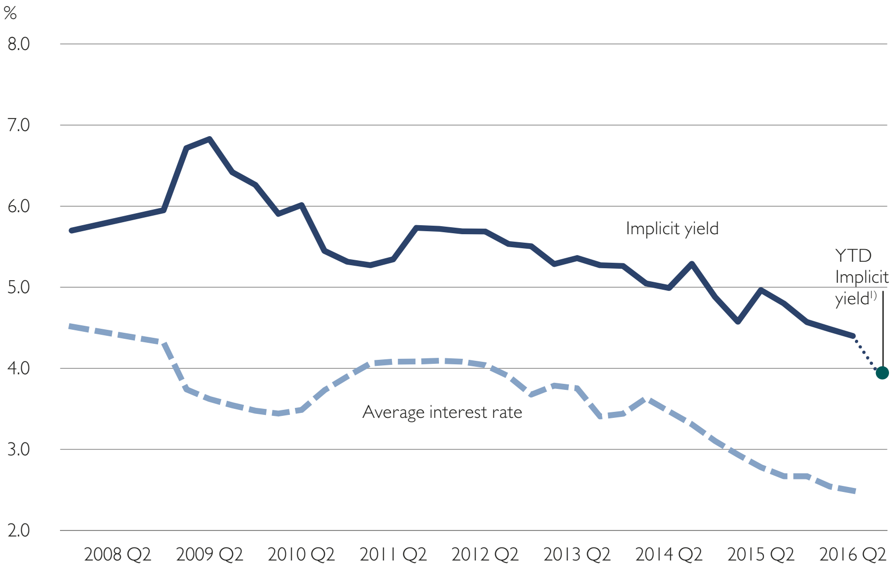
Premium or discount – market capitalization as share of EPRA NAV



Note. Property companies on Nasdaq OMX Nordic Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

For the fifth consecutive quarter, the implicit yield among the listed property companies on Nasdaq OMX Nordic Main Market has decreased. Currently at 4.4 per cent, the implicit yield among the listed property companies is historically low. The decrease in the property companies' implicit yield mirrors the falling interest rates among said companies. Furthermore, the year-to-date implicit yield, based on market data from 5 September 2016, has decreased further to slightly less than 4 per cent. This suggests that the implicit yield among listed property companies will continue to fall in the next quarter. However, considering the correlation between the listed property companies' implicit yield and their average interest rate, implicit yields are unlikely to decrease further unless the companies' interest rates continue to fall – the spread between the two parameters has stabilized around 1.9 percentage points for the past three quarters.

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



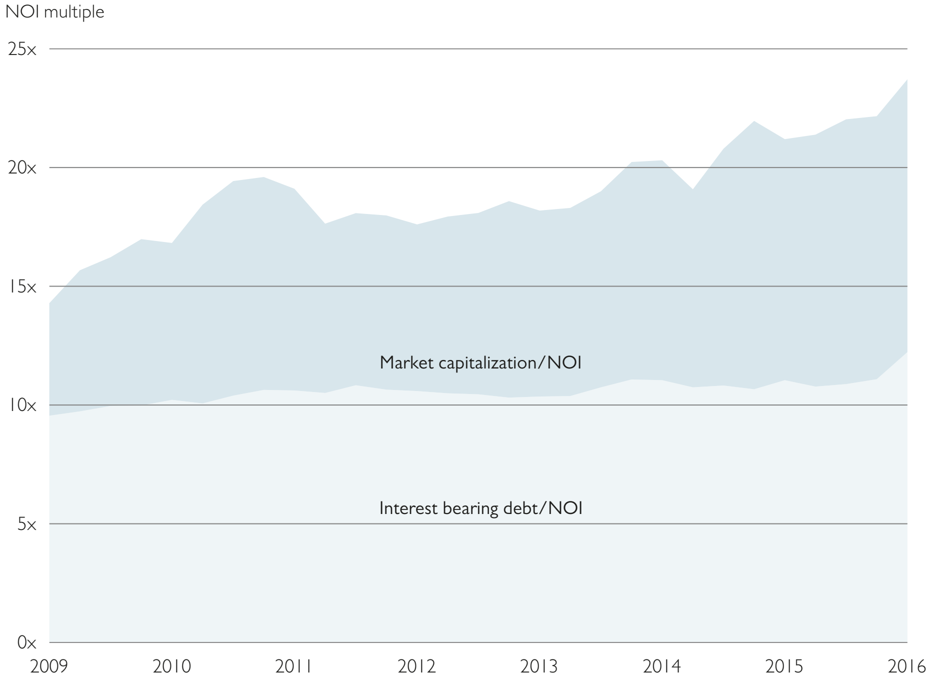
[1] Market values 2016-09-05 and Q2 2016 EPRA NAV.

Note. Property companies on Nasdaq OMX Nordic 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, now corresponding to 5.5 per cent.

Source: Catella, annual reports, Nasdaq.

The proportion of interest-bearing debt to net operating income has been relatively stable over the past seven years, while the proportion of market capitalization to net operating income has more than doubled. A possible reason for this is that banks have become more restrictive with their lending following the financial crisis, while the stock market is more inclined to value net operating income higher in times of low interest rates and a growing economy. Interestingly, during the second quarter of 2016 the listed property sector increased its interest-bearing debt from 11.1 to 12.2 times its net operating income, while market capitalization only increased from 11.1 to 11.5 times net operating income. A contributing factor to this development is Castellum's acquisition of Norrporten, which substantially increased the company's interest-bearing debt in relation to its net operating income.

Interest-bearing debt and market capitalization in relation to NOI



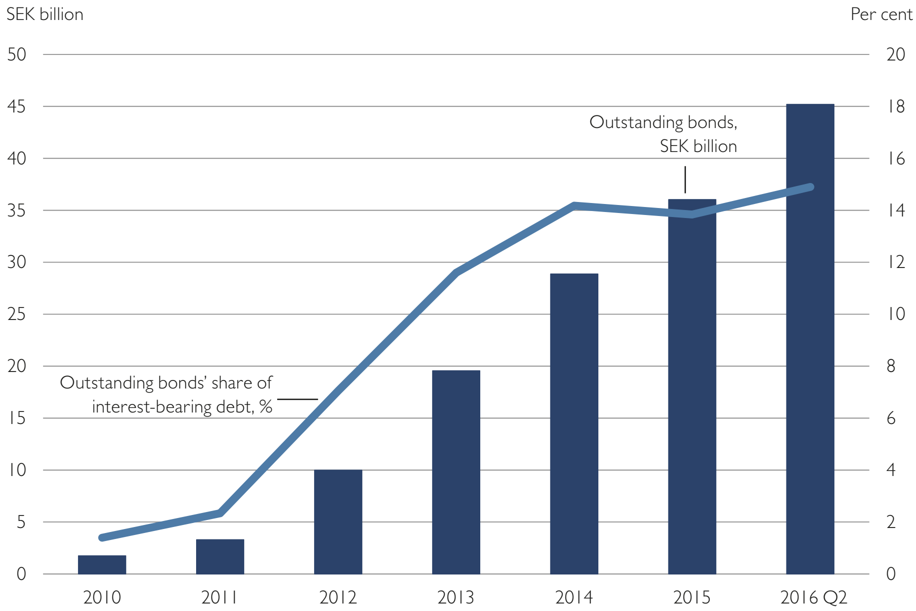
Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Bonds

Corporate bonds appear to be back in fashion as the majority of the listed property companies have issued new bonds in the second quarter of 2016.

The second quarter of 2016 saw the greatest increase in the volume of outstanding corporate bonds on the Swedish property market in more than two years. The listed property companies on Nasdaq OMX Nordic Main Market issued a record SEK 6.1 billion in corporate bonds during the quarter, which is nearly as much as in the entire year of 2015. This puts the total volume of oustanding bonds at SEK 45.2 billion. Outstanding bonds' share of interest-bearing debt increased by 0.4 percentage points in the second quarter of 2016. Accordingly, bonds make up 14.9 per cent of the listed property companies' interest-bearing debt, which is the highest proportion ever recorded. Two companies were particularly active during the second quarter, with Atrium Ljungberg increasing its outstanding bonds by SEK 900 million and D. Carnegie & Co doubling the volume of its outstanding bonds from SEK 1 billion to SEK 2 billion.

Outstanding bonds

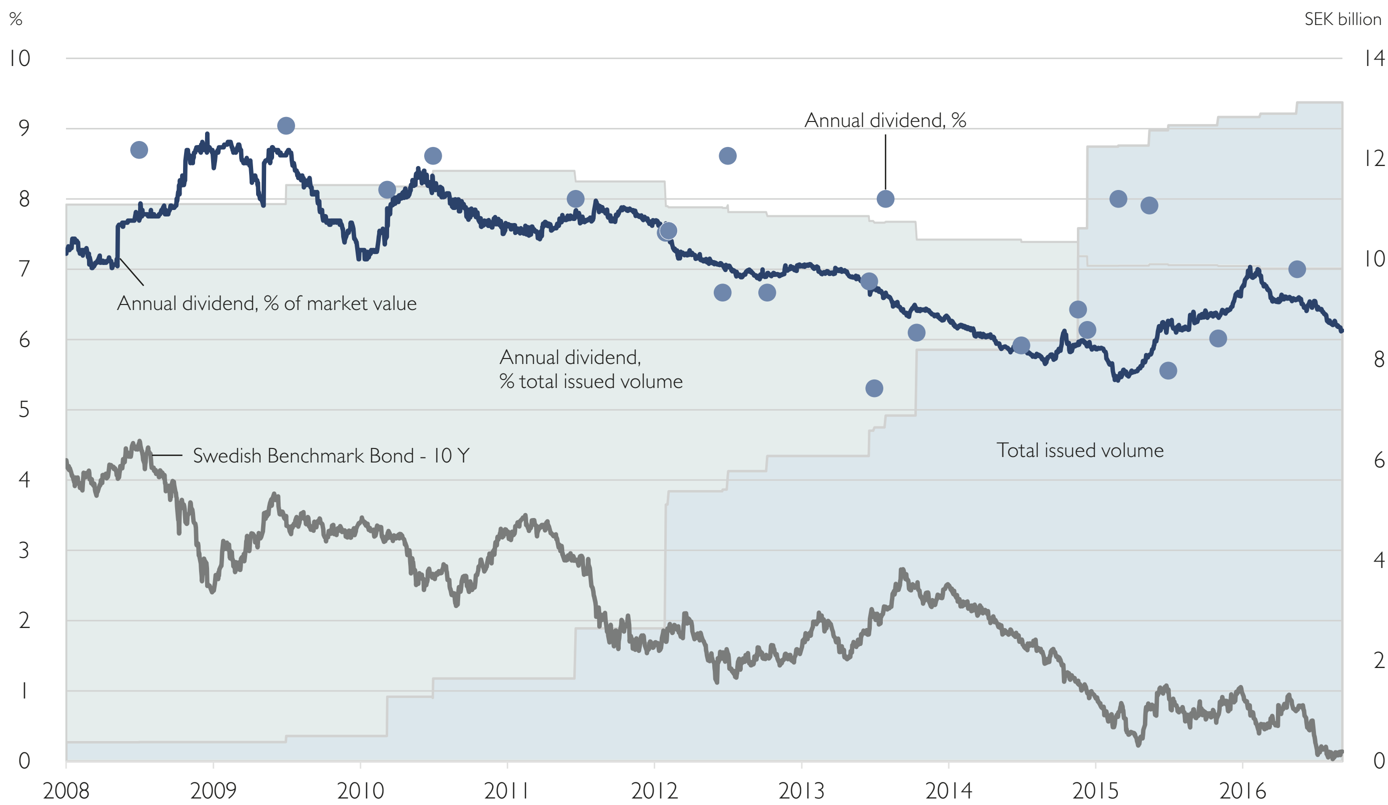


Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Preference shares

The average dividend of property-related preference shares on Nasdaq OMX Nordic Main Market fell sharply in the second quarter of 2016, coinciding with long-term bond rates approaching zero. In addition, Sagax recently announced that it is introducing a new, competing type of security.

Property companies' preference shares on Nasdaq OMX Nordic Main Market



Between February 2015 and February 2016, the average dividend of property-related preference shares on Nasdaq OMX Nordic Main Market increased from 5.4 per cent to 7 per cent. This development marked the reversal of a five-year trend of falling average dividends on the secondary market. However, since mid-February 2016 the average dividend of property-related preference shares has fallen substantially, and is quickly approaching the six per cent mark. As of 5 September 2016, the average dividend of the property companies' preference shares on Nasdaq OMX Nordic Main Market is 6.1 per cent.

In addition to the development on Nasdaq OMX Nordic Main Market, there have been some interesting developments on Nasdaq First North.

First, in June 2016, Tobin Properties announced that it would redeem half of all its Class A preference shares at SEK 110 per share, causing the price of the preference share to fall on the secondary market. Tobin Properties' redemption of their preference shares is yet another example of why some investors are deterred from purchasing preference shares: the risk of the issuer redeeming the shares at the investors' loss. Nevertheless, as of 5 September, Tobin Properties' preference share has returned to SEK 114 per share, not far from its pre-redemption price.

Second, another property company listed on Nasdaq First North – Genova Property Group – recently issued 1.2 million new preference shares at SEK 115 per share, which amount to SEK 138 million in new capital. On the day of the issue the preference share price fell by approximately 4 per cent, but it recovered within a couple of days.

Furthermore, Sagax recently made the news with the announcement of the new Class D common shares, which will likely have an impact on the market for preference shares. Described as "a preference share without preference", the new Class D share will initially yield a maximum dividend of 7.55 per cent. However, unlike preference shares, the Class D shares will not have preference over the Class A and Class B shares. Sagax is credited with reintroducing preference shares on the Swedish property market in 2006, and the fact that Sagax is now moving towards a different type of high-yielding security is viewed by some as a move away from preference shares.

According to Sagax, the new Class D common share is introduced in order to maximize the company's credit rating, as preference shares are generally viewed as equal parts equity and debt by the rating agencies. As Sagax is looking to increase its presence on bond markets, credit ratings are becoming increasingly more important.

CREDI – Catella's view through the looking glass

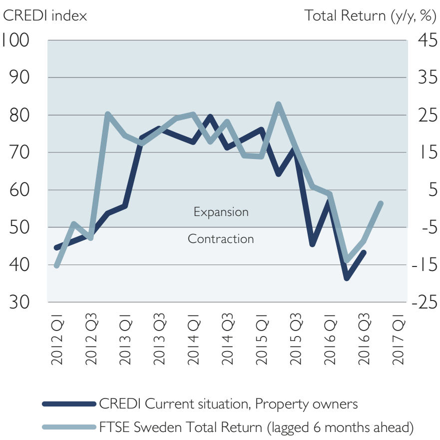
Slower GDP growth combined with the bottoming-out of the repo rate indicates that property yields are about to go up.

Although credit sentiments have improved in the past quarter the debt financing market is still in contraction, despite increased risk tolerance among investors and the tightening of credit spreads between high- and low-rated bonds. This is most likely a sign of banks' risk averseness and unwillingness to increase their property exposure.

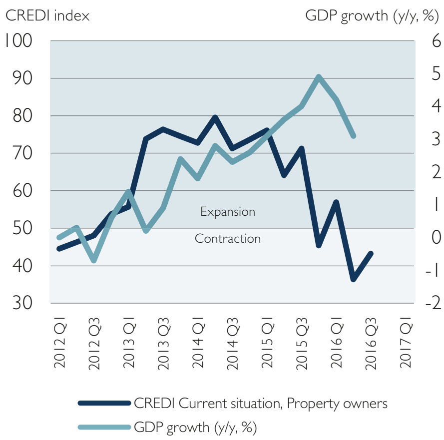
The Swedish equity market is strongly correlated with the CREDI Current Situation index over time. The equity markets had a turbulent start in 2016, but have recovered over the summer, mainly due to expectations of more central bank stimulus in Europe and Japan following the Brexit vote. The recovering equity market helped improve the CREDI Current Situation index in the September survey, after an all-time-low in June 2016. Although the CREDI Current Situation index is still below the 50.0 turning point, the equity market is pointing towards an improvement.

However, the property market will reach an inflection point sometime in the spring of 2017. This is due to a combination of factors. First, the CREDI Current Situation index is leading property yields by approximately four quarters. As a result, last year's deterioration in credit sentiments is expected to affect property yields negatively from Q4 2016 onwards. Second, after a 13-quarter-long trend of steadily improving GDP growth, the economy peaked in Q4 2015 and growth has since slowed down – a trend that will most likely continue in 2017. Moreover, following 19 quarters of interest rate cuts, the Riksbank's repo rate appears to have bottomed out at -0.5 per cent. GDP growth and the repo rate are leading indicators of the property market by four and seven quarters, respectively, and have been important contributors to the declining property yields up until now. However, this effect on the property market will end in Q4 2016, after which the decelerating GDP growth will start to push average yields upwards, while the downward pressure of a constantly falling repo rate will fade out. This is expected to result in higher property yields, in particular for commercial properties in secondary locations and in smaller cities. However, low bond yields and volatile equity markets mean that high-quality properties in Swedish growth cities will remain highly attractive to investors.

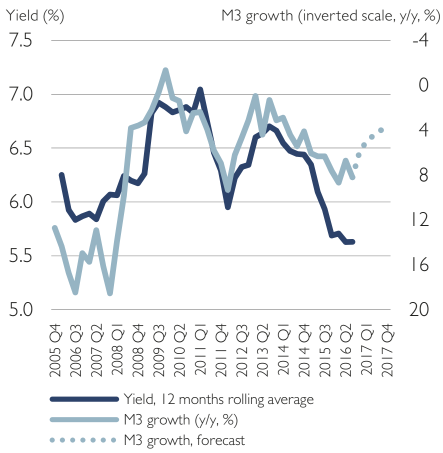
FTSE Sweden and CREDI Current Situation for property owners



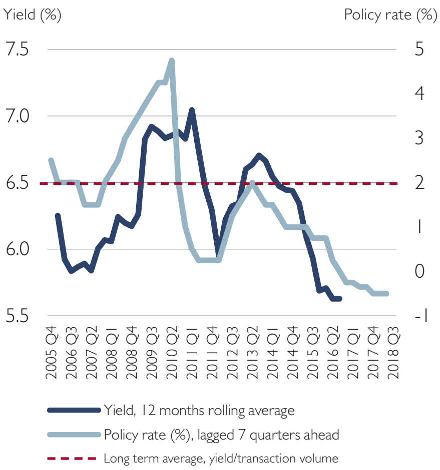
GDP growth and CREDI Current Situation for property owners



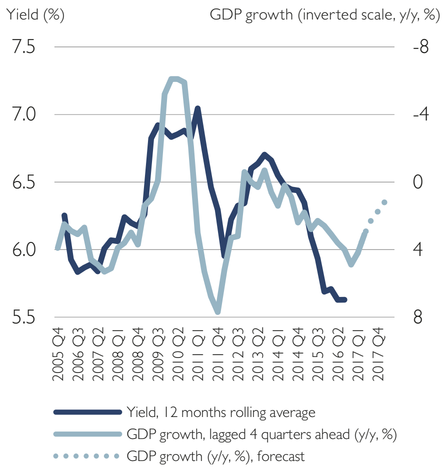
The M3 growth and average yield*



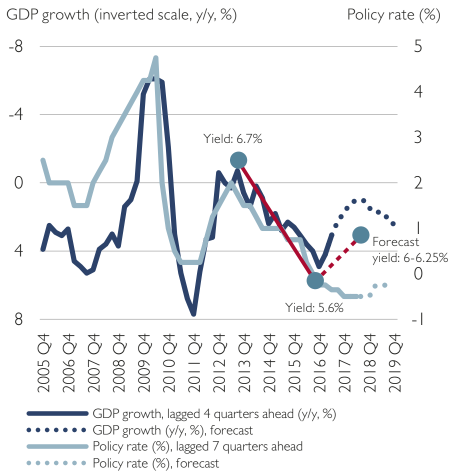
Yields and policy rate*



Yields and GDP growth*



Yields, GDP growth and policy rate*



Source: FactSet and Catella

* Yields are based on historical office and retail transactions in Sweden. Yields are either verified or estimated by Catella.

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