CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

CREDI April 2018

# Credit market has improved for second consecutive quarter

In the April issue of CREDI, the Main index increased from 50.3 to 50.5, marking the second time the credit market has improved since September 2015. Property companies remain optimistic, while banks have become slightly less cautious. Furthermore, the volume of outstanding bonds among property companies has increased substantially.

### CREDI MAIN INDEX ABOVE 50.0 FOR SECOND STRAIGHT QUARTER

In the April survey of CREDI, the Main index increased from 50.3 to 50.5, marking an improved credit market. This is the second time the credit market has improved since September 2015.

### PROPERTY COMPANIES REMAIN POSITIVE TO THE CREDIT MARKET

As has been the case throughout the history of CREDI, property companies view the credit market more positively than banks. In the April survey, property companies had a Main index of 56.4, indicating a noticeably improving credit market.

### INTEREST RATES LEVELLING OUT WHILE LOAN-TO-VALUE IS FALLING

Following four years of falling interest rates, the average interest rate of property companies listed on Nasdaq Stockholm Main Market appears to be levelling out at approximately 2.3 per cent.

### PROPERTY SHARES ARE TRADING AT A DISCOUNT

At the end of the fourth quarter of 2017, the common shares of property companies on Nasdaq Stockholm Main Market were trading at a discount, due to increasing property values.

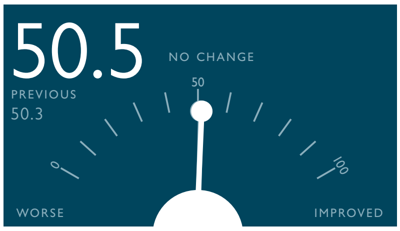
### VOLUME OF BONDS INCREASED BY 80 PER CENT IN 2017

In 2017, the volume of outstanding bonds among property companies on Nasdaq Stockholm Main Market increased from SEK 51 billion to SEK 91 billion, which is an 80 per cent increase. Bonds currently make up 25 per cent of interest-bearing debt.

### FIRST NEW ISSUE OF PREFERENCE SHARES SINCE MAY 2016

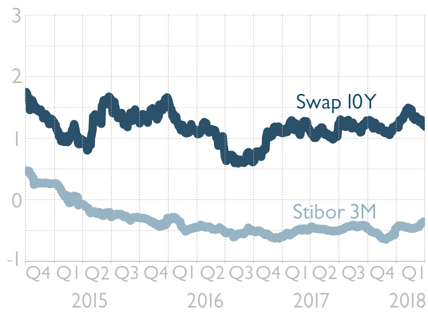
In 2017, the volume of property-related preference shares decreased by more than 30 per cent. However, in the spring of 2018, NP3 issued approximately SEK 288 million in new preference shares, the first new issue since May 2016.

CREDI Main index




| Banks | Corporates |
|---|---|
| 44.6 | 56.4 |
| 43.0 | 57.6 |

Swedish key interest rates, 2014–2018. Per cent




| Loan-to-value Q4 average | Interest rate Q4 average | Fixed credit term Q4 average | Fixed interest term Q4 average |
|---|---|---|---|
| 52.0% | 2.3% | 3.4 y | 2.7 y |

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

# The CREDI Survey

The CREDI Main index increased from 50.3 to 50.5 in the April survey of CREDI. This is the second consecutive quarter where the Main index has been above the 50.0 turning point, which is the first time for this to happen since September 2015.

### Main index components

In the April issue of CREDI, the Main index reaches past the 50.0 turning point for the second consecutive quarter, indicating an improving credit market over the past six months.

The improved Main index is a result of a particularly strong Current Situation index at 54.8, which is at its highest point in more than two and a half years.

Property companies remain more positive of the current credit market with a Current Situation index of 62.8, while banks have a more reserved Current Situation index of 46.9, indicating that the credit market has worsened slightly.

This discrepancy between property companies and banks has been present from time to time in the history of CREDI. The reason for this discrepancy could be that banks cater to a wider range of clients, while listed property companies are generally strong borrowers that have also been successfully tapping into the attractive bond market.

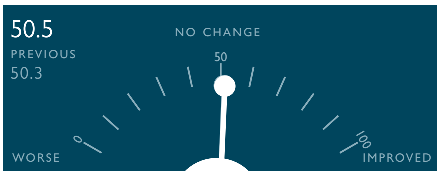
The Expectation index is considerably lower than the Current Situation index. Property companies believe that the credit market will remain fairly stable, while banks hold a less optimistic view of the credit market's future development.

To sum up, this means that the market as a whole believes that the credit market has improved over the past three months, and that it is expected to worsen somewhat over the next three months.

### Sub-indices

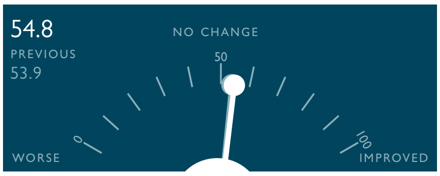
Looking at the results from the April survey, we see that the sub-indices Credit Availability, Credit Margins and Duration have had the most positive impact on the Current Situation index. With regard to the Expectation index, the sub-indices Credit Margins and Leverage have had the most negative impact.

## CREDI Main index



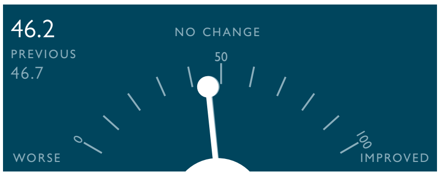

| Banks | Corporates |
|---|---|
| 44.6 | 56.4 |
| 43.0 | 57.6 |

## Current Situation




| Banks | Corporates |
|---|---|
| 46.9 | 62.8 |
| 45.3 | 62.5 |

## Expectation




| Banks | Corporates |
|---|---|
| 42.4 | 50.1 |
| 40.6 | 52.8 |

## 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.

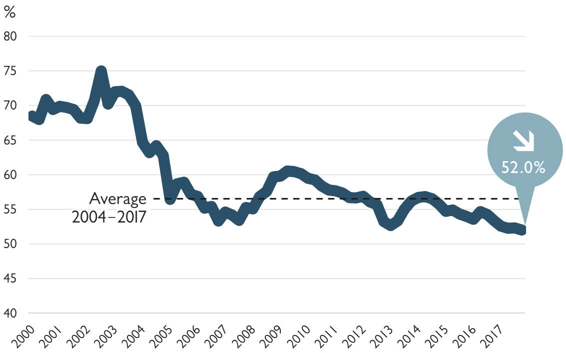
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 fourth quarter of 2017 is characterised by a seemingly stable credit market, which is reflected by the fact that three of the four CREDI indices remain fairly unchanged.

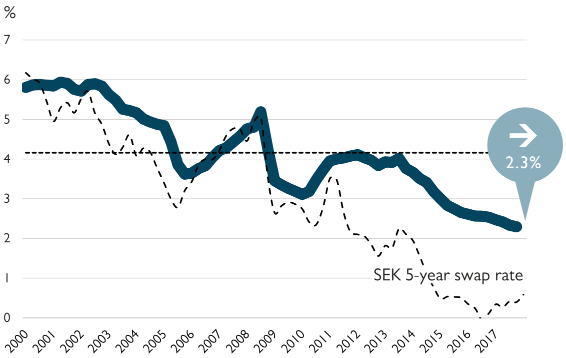
## Listed sector Q4 average loan-to-value[1]




Listed property companies' loan-to-value fell from 52.3 per cent in the third quarter of 2017 to 52.0 per cent in the fourth quarter of 2017, pushing the loan-to-value even further below the historical average of 56.5 per cent. While interest-bearing debt has increased among listed property companies, property values increased slightly more, which caused the companies' loan-to-value to decrease.

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

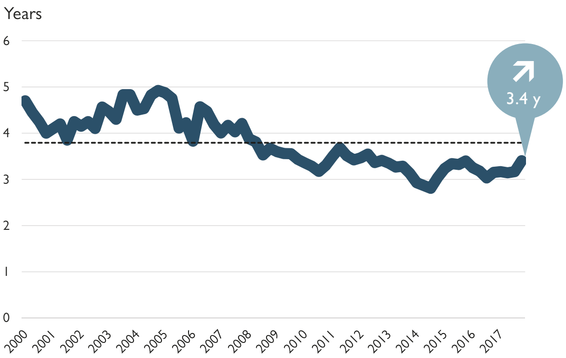
## Listed sector Q4 average interest rate[2]




In the fourth quarter of 2017, the average interest rate remained at 2.3 per cent. This means that the average interest rate has not increased since the third quarter of 2013. The vast majority of property companies reported an unchanged interest rate during the quarter, the main exception being Atrium Ljungberg which lowered its average interest rate considerably during the quarter, from 2.0 per cent to 1.7 per cent.

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

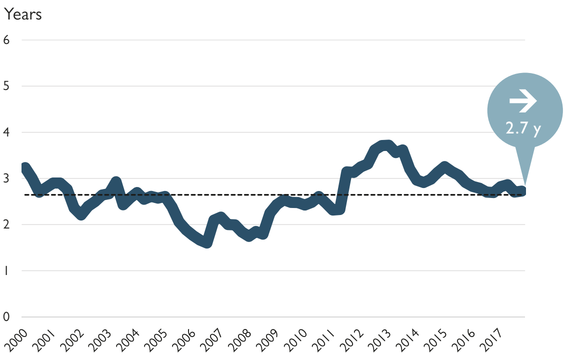
## Listed sector Q4 average fixed credit term[3]




The average fixed credit term among listed property companies increased from 3.2 years to 3.4 years in the fourth quarter of 2017. More than half of the surveyed companies extended their fixed credit terms during the quarter, some of them considerably.

3 Average maturity referring to interest-bearing debt.

## Listed sector Q4 average fixed interest term[4]




-------- Average 2000–2017

The average fixed interest term among listed property companies remained at 2.7 years in the fourth quarter of 2017. Accordingly, the average fixed interest term is at the same level as during the third and fourth quarter of 2016, and remains fairly close to the long-term 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.

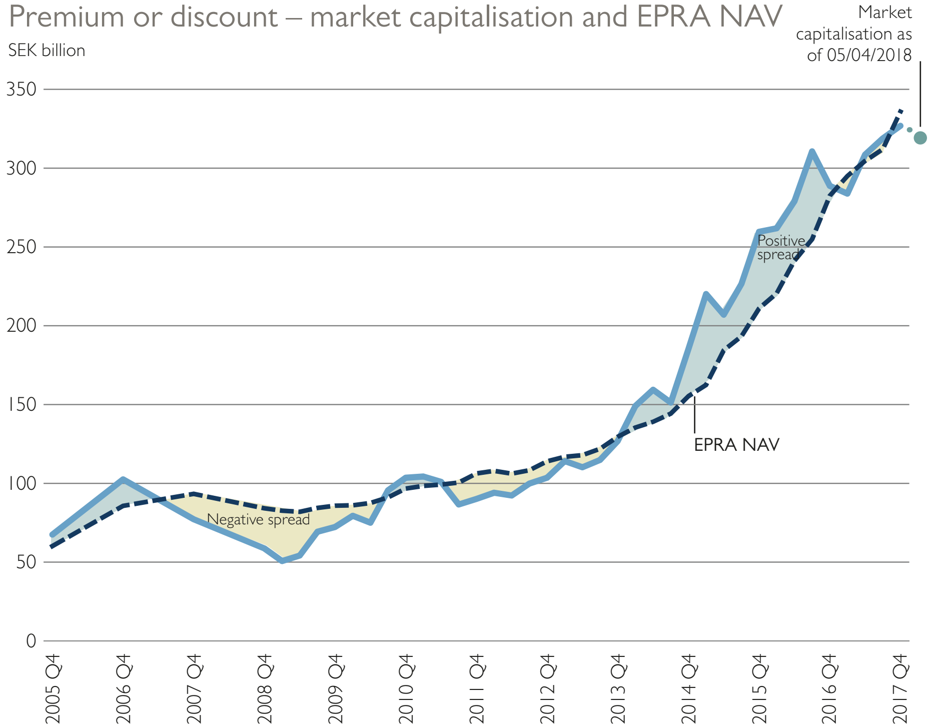
# Common shares

During the fourth quarter of 2017, listed property companies have seen their property values increase at a considerably higher rate than the stock market, causing property shares to be traded at a slight discount at the end of the year.

Shares in property companies on Nasdaq Stockholm Main Market traded at a slight discount at the end of the fourth quarter of 2017. Market capitalisation increased from SEK 319 billion to SEK 327 billion, while the property companies' EPRA NAV increased from SEK 312 billion to SEK 336 billion. As such, property values have increased at a faster pace than the stock market, causing property shares to be traded at a discount. Since the end of the year, the stock market has fallen slightly and the listed property companies' market capitalisation is approximately SEK 322 billion as of 5 April 2018, meaning that we might see a second quarter of market discounts. Furthermore, if D. Carnegie & Co and Victoria Park, two property companies that are still trading at a premium, were to exit the stock market following buy-outs, the market discount might become even more pronounced.

Premium or discount – market capitalisation and EPRA NAV

SEK billion

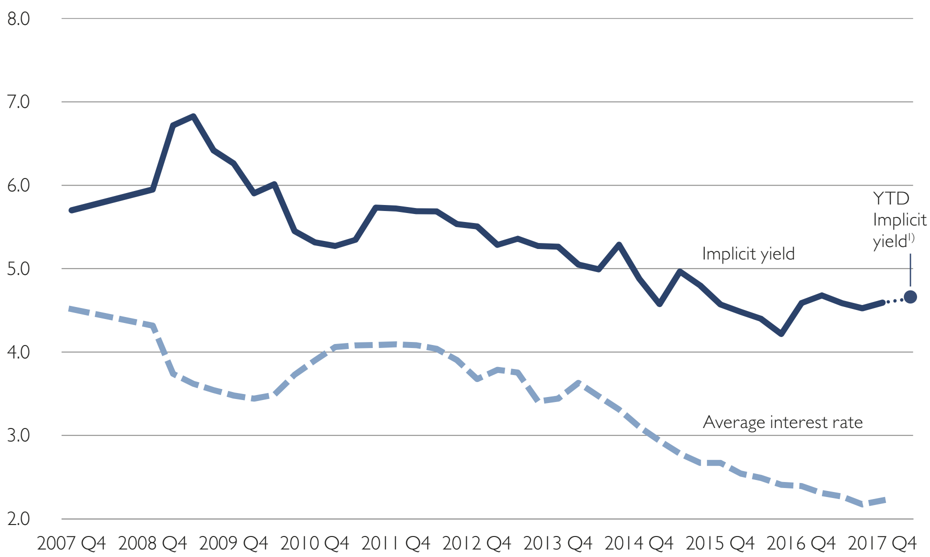



Note. Property companies on Nasdaq Stockholm Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

The implicit yield of property companies on Nasdaq Stockholm Main Market increased slightly from 4.5 per cent in the third quarter of 2017 to 4.6 per cent in the fourth quarter of 2017, reverting back to the level seen in the beginning of the year. Furthermore, the slight decrease in the stock market since then has not affected the year-to-date implicit yield, which remains at 4.6 per cent as of 5 April 2018.

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

Per cent



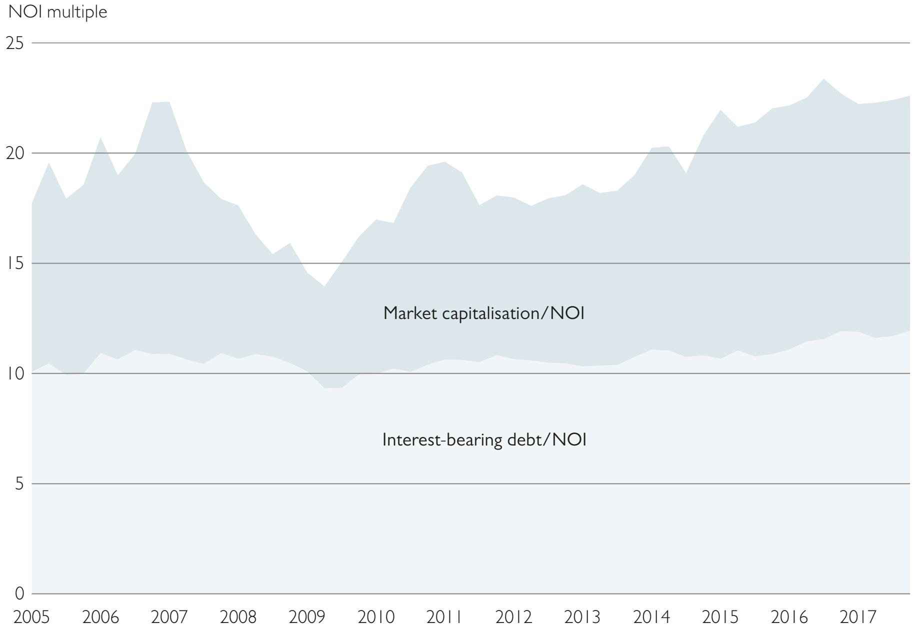

[1] Market values 05/04/2018 and 2017 Q4 EPRA NAV.

Note. Property companies on Nasdaq Stockholm Main Market. Average interest rate is weighted by using the EPRA NAV to Book value of properties-ratio. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent.

Source: Catella, annual reports, Nasdaq.

In 2007, the stock market valued the listed property sector at 11.4 times its net operating income, while interest-bearing debt was approximately 10.9 times net operating income. In reaction to the financial crisis, however, market capitalisation decreased to 4.5 times net operating income, while debt never fell below a multiple of 9.3. This means that banks have adjusted their lending in tandem with property companies' cash flow development, which has resulted in a lower loan-to-value as property value has increased faster than net operating income. In the fourth quarter of 2017, interest-bearing debt increased from 11.7 to 11.9 times net operating income, while market capitalisation remains at 10.7 times net operating income for the third consecutive quarter.

### Interest-bearing debt and market capitalisation in relation to NOI



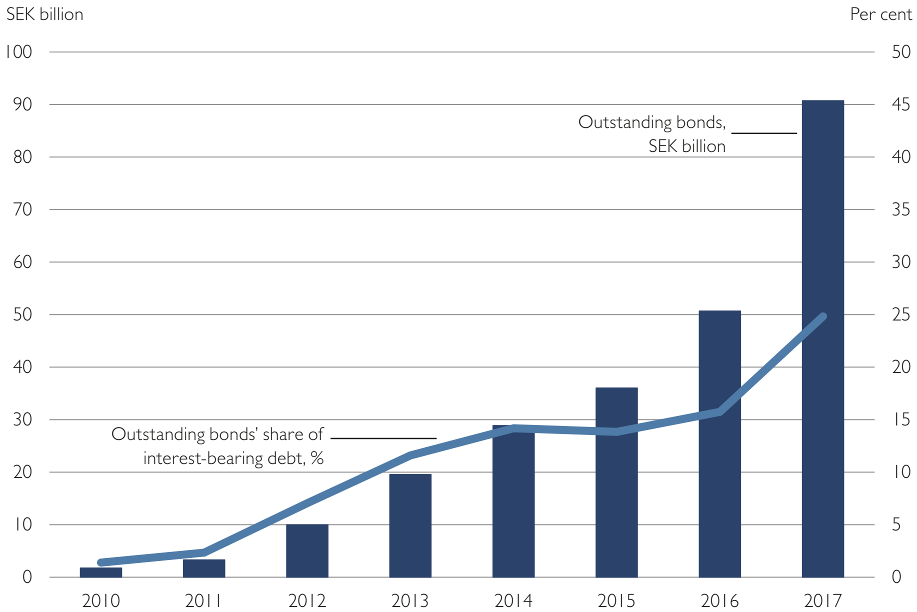

Note. Property companies on Nasdaq Stockholm Main Market.

# Bonds

**By the end of 2017, property companies' volume of outstanding bonds and its share of interest-bearing debt had both reached an all-time high.**

During the year 2017, outstanding bonds among listed property companies on Nasdaq Stockholm Main Market increased by 80 percent, from 50.7 billion to an impressive 90.7 billion. Approximately half of this increase is attributable to Balder, which has issued nearly SEK 20 billion in bonds throughout the year. Other property companies that have been active on the bond market during the year include Atrium Ljungberg, Castellum and Fabege. Furthermore, bonds make up an increasingly large share of property companies interest-bearing debt. At the end of 2017, bonds made up 25 per cent of interest-bearing debt, which is the highest share ever recorded.

### Outstanding bonds

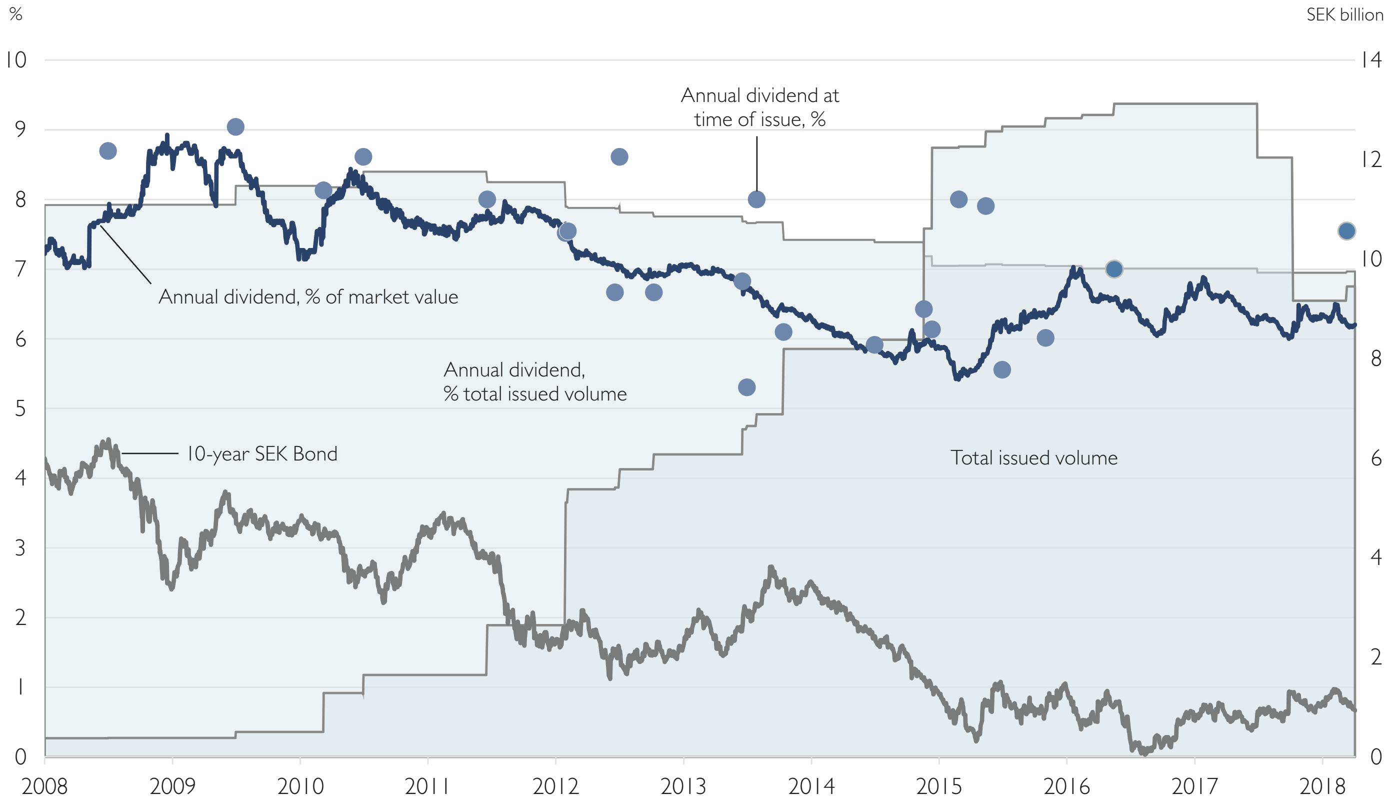



Note. Property companies on Nasdaq Stockholm Main Market.

# Preference shares

The preference share market has been unusually eventful during the past year, with substantial redemptions by Balder and Sagax as well as a new issue by NP3. At the same time, the secondary market for preference shares appears to have recovered from last year's turbulence.

## Property companies' preference shares on Nasdaq Stockholm Main Market




At the beginning of 2017, the market for property-related preference shares on Nasdaq Stockholm Main Market was fairly uneventful, a situation that was not looking to change anytime soon. There had not been a single new issue of preference shares since May 2016, and the secondary market was basically tracking long-term interest rates.

Nevertheless, the year 2017 would turn out to be an eventful one for preference shares. The market would shrink significantly as property companies were looking at other sources of capital and debt. During the year, the outstanding volume of preference shares fell by more than 30 per cent, following significant redemptions by Sagax and Balder. Sagax replaced the majority of its preference shares with its high-yielding D class common share, while Balder redeemed all of its 10 million preference shares and replaced them with a hybrid bond.

In the spring of 2018, NP3 issued approximately SEK 288 million in new preference shares, marking the first new issue of property-related preference shares on Nasdaq Stockholm Main Market since May 2016.

Interestingly, the preference share issued in May 2016, housing developer Oscar Properties' class B preference share, is likely to be redeemed. This preference share has performed noticeably better than the company's class A preference share, due to the owner's right to request that the issuer redeem the share at SEK 500. However, the company recently announced that the holders of nearly 70 per cent of the preference shares have asked to have their shares redeemed. As a result, the volume of outstanding preference shares will likely decrease by at least SEK 137 million.

Alongside the eventful primary market, the secondary market has been strong in recent months. In the autumn of 2017, the secondary market for preference shares took a substantial hit as reports of postponed residential projects were circulated in the news. However, the average dividend has fallen in recent months, and is currently at 6.2 per cent as of 4 April 2018.

# Catella's view through the looking glass

**Positive credit sentiments among the major investors and expectations of continually low real interest rates indicate a strong demand for well-located properties in the major cities.**

The Swedish equity market has been a strong leading indicator of the CREDI Current Situation index for property owners over time. The equity market indicates that index levels will fall back somewhat, but remain above the 50-mark in the coming quarters. However, the wide gap in access to credit between the large, well-established property companies and smaller investors without a strong track-record will most likely remain.

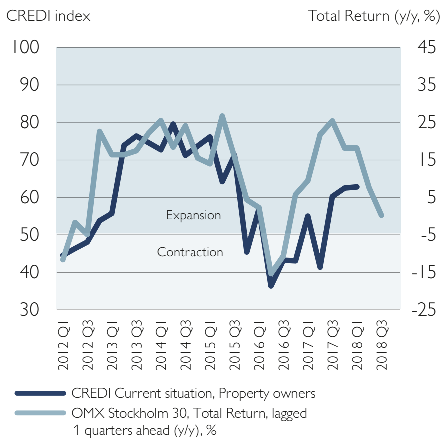
The CREDI Current Situation index for property owners is a good leading indicator of Swedish banks' lending to property companies. This is, in turn, a leading indicator of the transaction volume for office and retail properties, which is expected to remain at today's levels in the coming quarters.

There is currently a strong investor interest in prime properties, while properties in secondary locations are getting increasingly hard to sell. Over the past six months, average yields have fallen in line with the transaction volumes. The yield decline can mostly be explained by lower average yields for office properties.

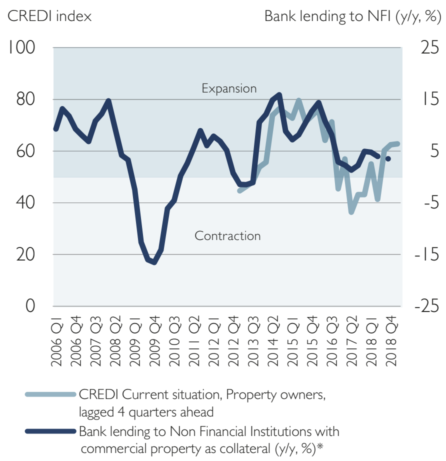
There are currently a large number of well-located office properties out on the market in Stockholm, which will become something of a litmus test of the investor appetite. Catella expects the average yields for commercial properties to increase over the coming 6–12 months (mainly by means of increasing yield spreads between A, B and C locations).

Catella expects condominium prices in Stockholm to fall by around 15 per cent from top to bottom (the price fall is around 10 per cent so far). Housing prices are a strong leading indicator of GDP growth, and the lower housing prices indicate falling residential investments and lower private consumption growth in 2018. Lower GDP growth (combined with somewhat less expansive monetary policy globally) is expected to slow down GDP growth significantly during the second half of 2018. This will affect the commercial property sectors with lower rental growth and more risk averse investors and banks. The underlying fundamentals for Swedish property, however, remain good with continuously low or negative real interest rates, resulting in a strong demand for properties in good locations in the major cities from institutions and investors with access to financing.

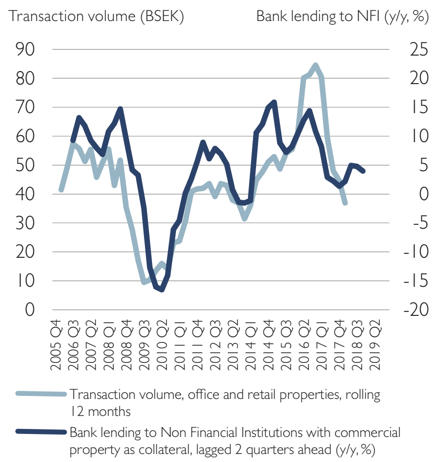
CREDI Current Situation and OMX Sthlm 30



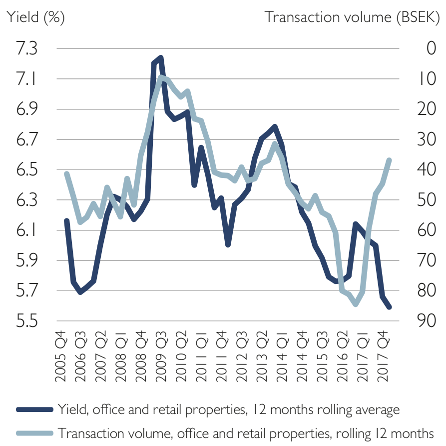

CREDI Current Situation and bank lending



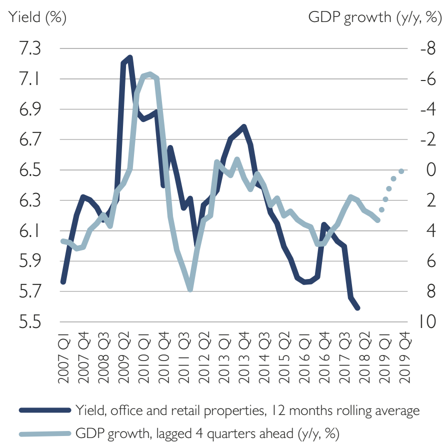

Transaction volume and bank lending



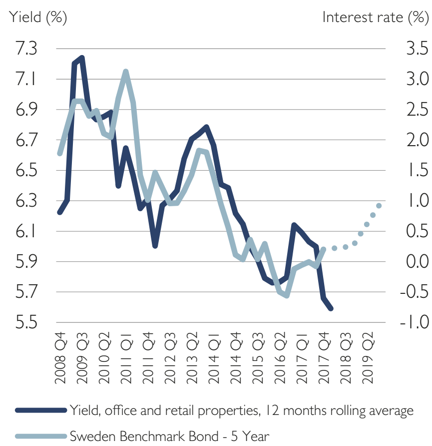

Average property yields* and transaction volume




Average property yields* and GDP growth




Average property yields* and interest rates




Source: FactSet and Catella

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

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