



CREDI July 2018

Optimistic outlook among banks as credit market improves

In the July issue of CREDI, the Main index increased from 50.5 to 54.3, which is the strongest index score since September 2015. Banks in particular view the current credit market positively, outscoring property companies for the first time in four years. Furthermore, the average interest rate has reached an historic low.

CREDI MAIN INDEX ABOVE 50.0 FOR THIRD STRAIGHT QUARTER

In the July survey of CREDI, the Main index increased from 50.5 to 54.3. It is the highest index score since September 2015, and marks the third straight quarter with an improving credit market.

BANKS HOLD MORE POSITIVE VIEW THAN PROPERTY COMPANIES

Breaking with tradition, the July survey of CREDI shows that banks have a more positive view of the current credit climate than property companies, with a Current Situation index score of 61.2 compared to 58.2. It is the first time this has happened since March 2014.

INTEREST RATES HAVE FALLEN TO A RECORD LOW

The average interest rate of listed property companies continues to fall. In the first quarter of 2018, the average interest rate fell to 2.2 per cent, which is the lowest rate observed in the history of CREDI.

PROPERTY SHARES ARE STILL TRADING AT A DISCOUNT

Although property companies' asset values have reached an all-time high, the stock market is becoming more careful in their valuation of property shares, which are still trading at a discount.

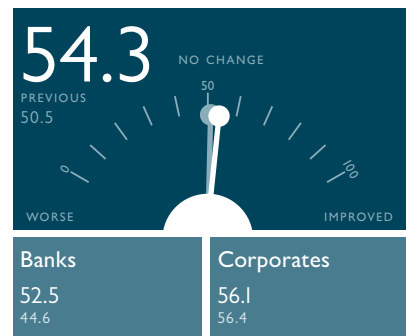
THE BOND MARKET SHOWS SIGNS OF LEVELLING OUT

The volume of outstanding bonds among property companies on Nasdaq Stockholm Main Market continues to increase, and is currently at SEK 98.2 billion. However, the bonds' share of interest-bearing debt shows signs of levelling out at 25 per cent.

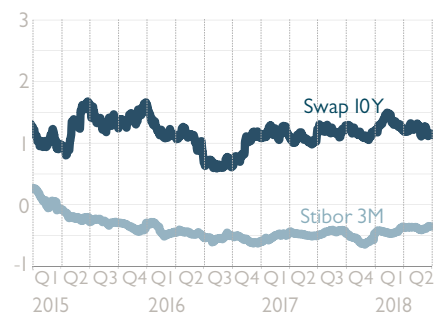
STRONG SECONDARY MARKET FOR PREFERENCE SHARES

Although the volume of property-related preference shares decreased by more than 30 per cent in 2017, and continues to decrease in 2018, the secondary market remains strong with an average dividend below 6 per cent.

CREDI Main index



Swedish key interest rates, 2015–2018. Per cent



Loan-to-value
Q1 average

→
52%

Interest rate
Q1 average

↓
2.2%

Fixed credit term
Q1 average

→
3.4 y

Fixed interest term
Q1 average

→
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 July survey of CREDI has seen a positive development, as the CREDI Main index increased from 50.5 to 54.3. This marks the third consecutive quarter of improving market sentiment, with banks having a particularly positive view of the credit market.

Main index components

The CREDI Main index reached 54.3 in the July survey of CREDI, which is its highest point since September 2015. The development of the Main index indicates an improving credit market over the past three quarters.

As observed over the past twelve months, the positive market sentiment reflected in the CREDI survey has been driven by a strong Current Situation index, which has reached 59.7 in the July survey. In addition, although the Expectation index has remained below the 50.0 turning point, it has increased from 46.2 to 48.9.

It is interesting to note that banks and property companies have aligned their views of the credit market considerably,

compared with previous surveys. Having differed by as much as 16.3 index points in September 2017, the gap has decreased to merely 3.7 index points.

In previous CREDI surveys, property companies has been more positive of the credit market, while banks have been more reserved. However, in the July survey, banks have indicated a substantially improved view of the credit market. In fact, banks have a higher Current Situation index than property companies for the first time since March 2014.

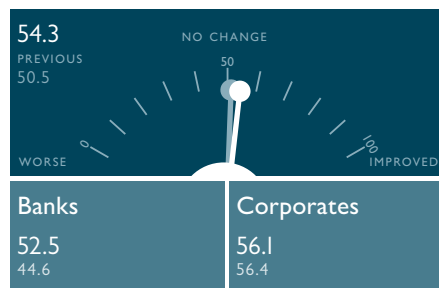
Banks remain less optimistic with regards to the future development of the credit market, but the banks' Expectation index is still at its highest point since November 2016.

Sub-indices

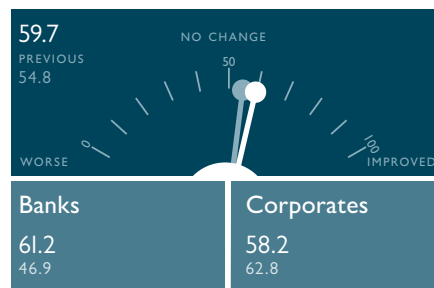
In recent quarters, bonds have become increasingly more popular among property companies, taking up a larger share of property debt. As such, banks have had to become more competitive in their lending, which is also reflected in the CREDI sub-indices.

Credit Availability, Credit Margins and Duration have had a significant positive effect on the Current Situation index, while the Leverage sub-index has remained unchanged.

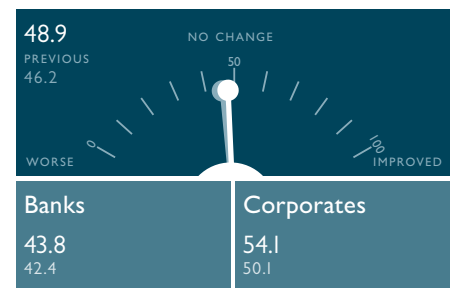
CREDI Main index



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



CREDIT MARGINS



LEVERAGE



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

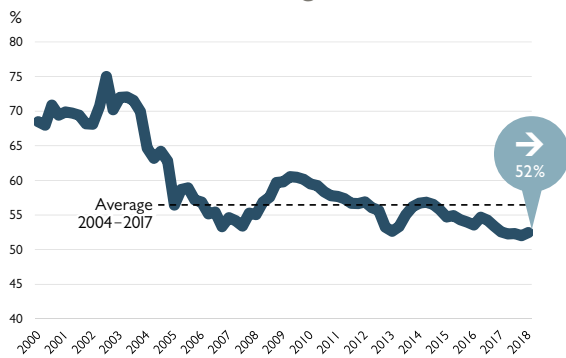
sentiment is 50 and any reading below this level indicates more difficult financing conditions while any reading above indicates less difficult financing conditions.

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 interim reports for the first quarter of 2018 indicate that property companies have seen a relatively stable credit market for the beginning of the year, while the average interest rate continues to fall.

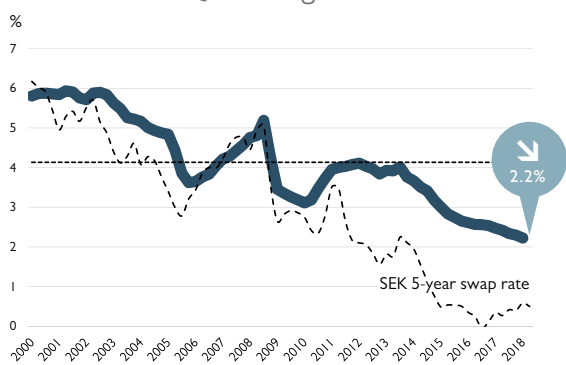
Listed sector Q1 average loan-to-value¹



Listed property companies' loan-to-value remained at 52 per cent in the first quarter of 2018, meaning that it stays below the historical average of 56 per cent. Although loan-to-value remained unchanged, the listed property companies' underlying interest-bearing debt and property values increased by approximately 5 per cent.

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

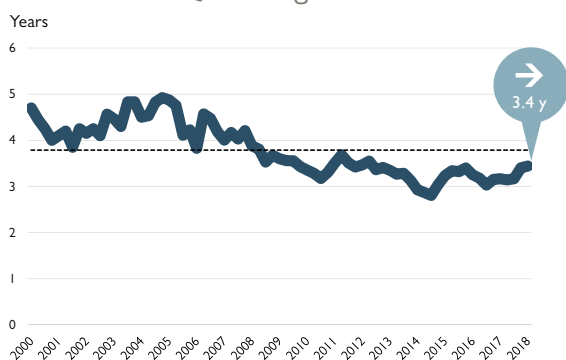
Listed sector Q1 average interest rate²



The average interest rate continues to fall. Since mid-2013, the interest rate has fallen from around 4 per cent to a record low 2.2 per cent in the first quarter of 2018. A majority of the listed property companies reported decreased interest rates during the quarter, with D.Carnegie and Kungsliden lowering their interest rates by a substantial 0.3 percentage points.

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

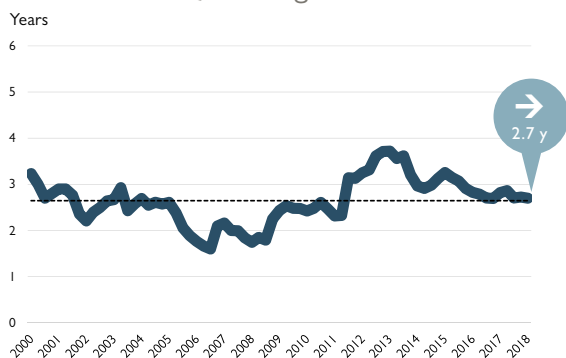
Listed sector Q1 average fixed credit term³



The average fixed credit term among listed property companies remained at 3.4 years in the first quarter of 2018, noticeably below the long-term average of 3.8 years. Around one third of the listed property companies extended their fixed credit terms during the quarter, while slightly more than half the companies reduced their fixed credit terms.

3 Average maturity referring to interest-bearing debt.

Listed sector Q1 average fixed interest term⁴



In the first quarter of 2018, the average fixed interest term among listed property companies remained at 2.7 years for the third consecutive quarter, close to the long-term average of 2.6 years. The long period of unchanged interest terms indicates that the listed property companies believe that interest rates will remain stable in the coming quarters.

4 Average maturity referring to interest-bearing debt.

----- Average 2000-2017

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.

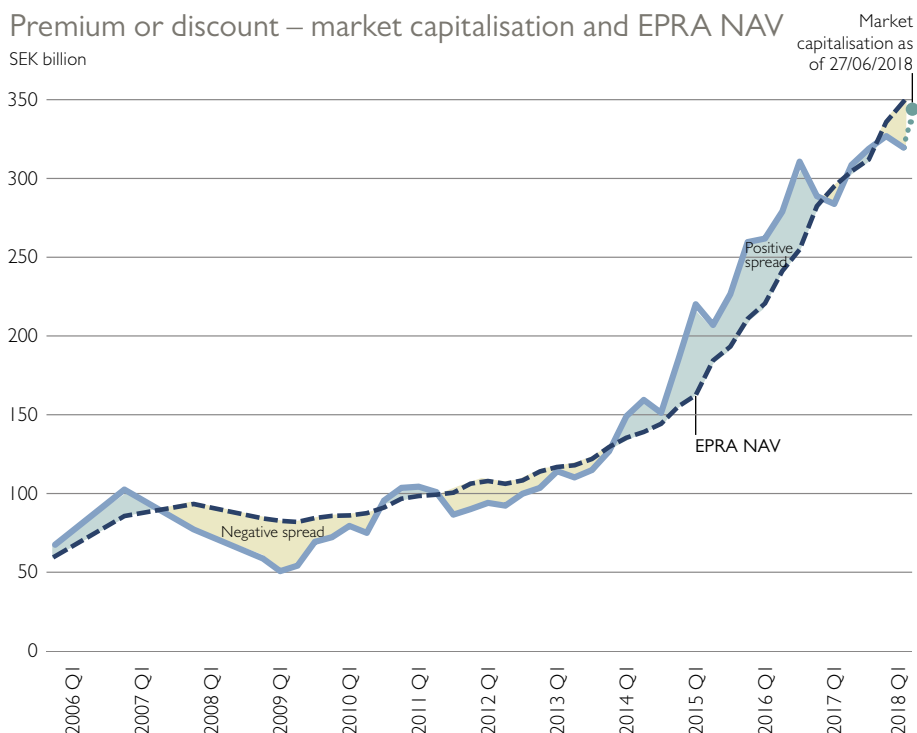
Each data point in the CREDI Indices represents the aggregate figure for Swedish listed property companies. Each company is weighted equally in order to fully reflect the company's individual financing strategy and financing situation. The start date is set as Q1 2000.

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

Common shares

The first quarter of 2018 indicates that the stock market is becoming more careful in their valuing of the listed property companies' net operating income and underlying assets, even though asset values have reached an all-time high.

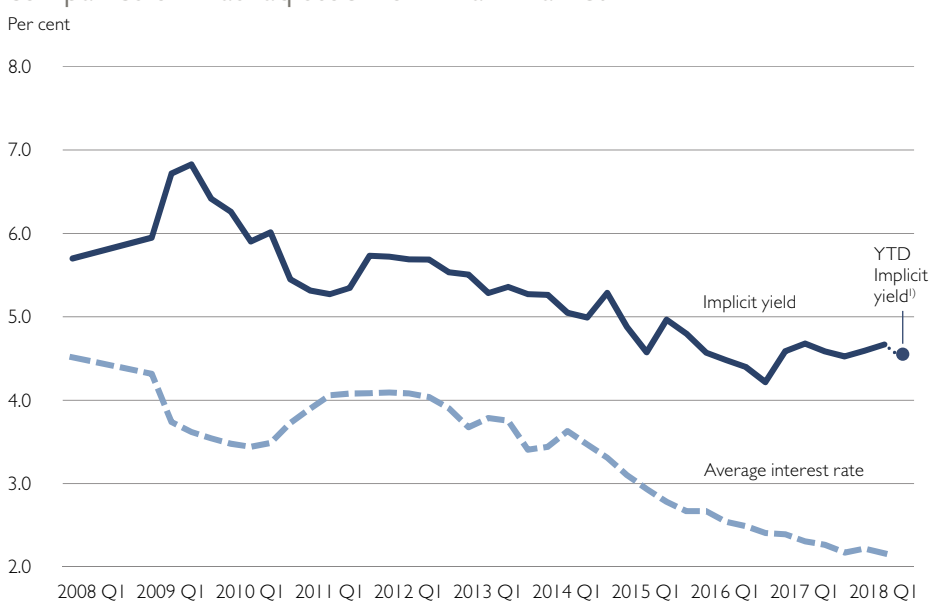
Shares in property companies on Nasdaq Stockholm Main Market traded at a noticeable discount at the end of the first quarter of 2018. Market capitalisation decreased from SEK 327 billion to SEK 320 billion, while the property companies' EPRA NAV increased from SEK 336 billion to SEK 349 billion. As such, property values have increased while the stock market has fallen, causing property shares to be traded at a greater discount. However, during the second quarter of 2018, the stock market has recovered considerably and the listed property companies' market capitalisation has reached approximately SEK 346 billion as of 27 June 2018. This indicates that we will see a less pronounced market discount at the end of the second quarter.



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 from 4.6 per cent in the fourth quarter of 2017 to 4.7 per cent in the first quarter of 2018, reverting back to the level seen in the beginning of 2017. However, the recovering stock market during the second quarter indicates a lower year-to-date implicit yield at 4.5 per cent as of 27 June 2018.

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

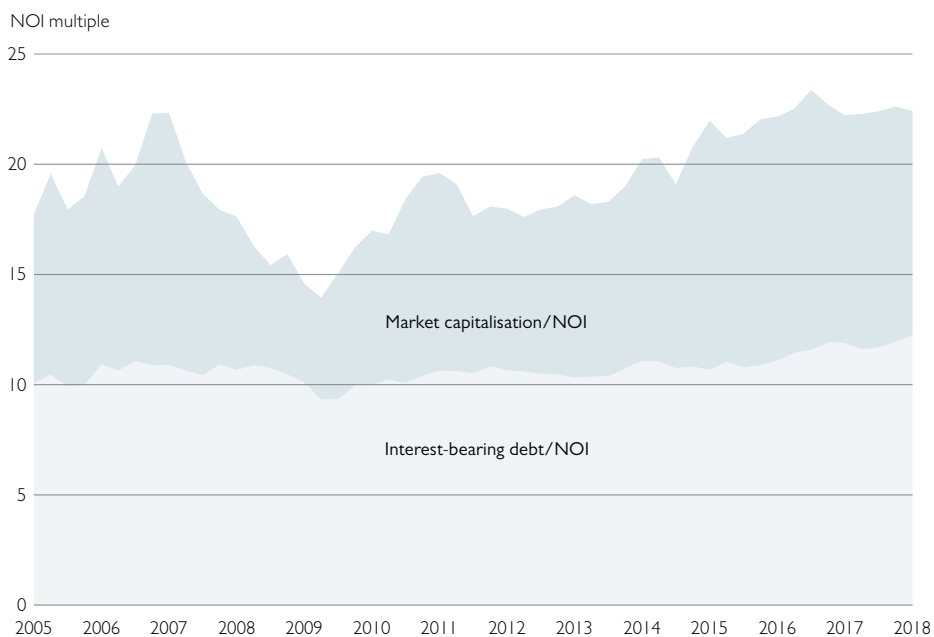


¹⁾ Market values 27/06/2018 and 2018 Q1 EPRA NAV.

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.

Historically, the credit market has had a more stable valuation of the listed property sector's net operating income than the stock market. This fact became particularly noticeable in 2009, when market capitalisation decreased to a multiple of 4.5 times net operating income, while debt remained at a multiple of 9.3. The credit market has adjusted its 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 first quarter of 2018, interest-bearing debt increased from 11.9 to 12.2 times net operating income, while market capitalisation fell from 10.7 to 10.2 times net operating income.

Interest-bearing debt and market capitalisation in relation to NOI



Note. Property companies on Nasdaq Stockholm Main Market.

Bonds

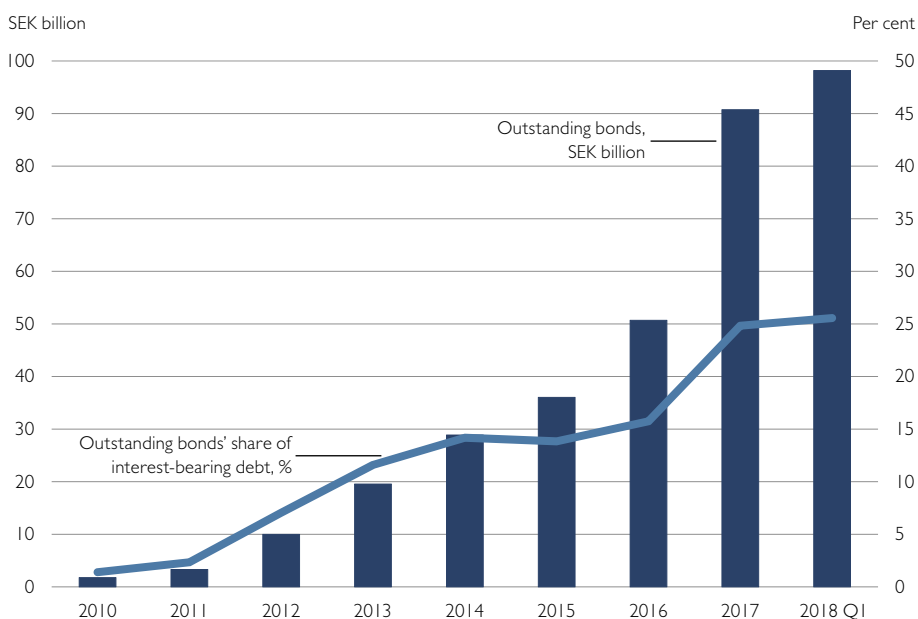
The volume of property companies' outstanding bonds continues to increase in the first quarter of 2018. However, the bonds' share of interest-bearing debt is showing signs of levelling out.

Following a record year for corporate bonds, where the volume of outstanding bonds among listed property companies on Nasdaq Stockholm Main Market increased by 80 percent from SEK 50.7 billion to an impressive SEK 90.7 billion, the first quarter of 2018 sees the volume of outstanding bonds increase by 8 percent to SEK 98.2 billion.

This increase is greatly attributable to Kungsleden, which issued several bonds during the quarter, including a SEK 2.5 billion green bond.

However, although the volume of outstanding bonds is increasing, the bonds' share of interest-bearing debt has only increased slightly from 24.8 per cent to 25.6 per cent, which could be a sign that the bond market is levelling out.

Outstanding bonds

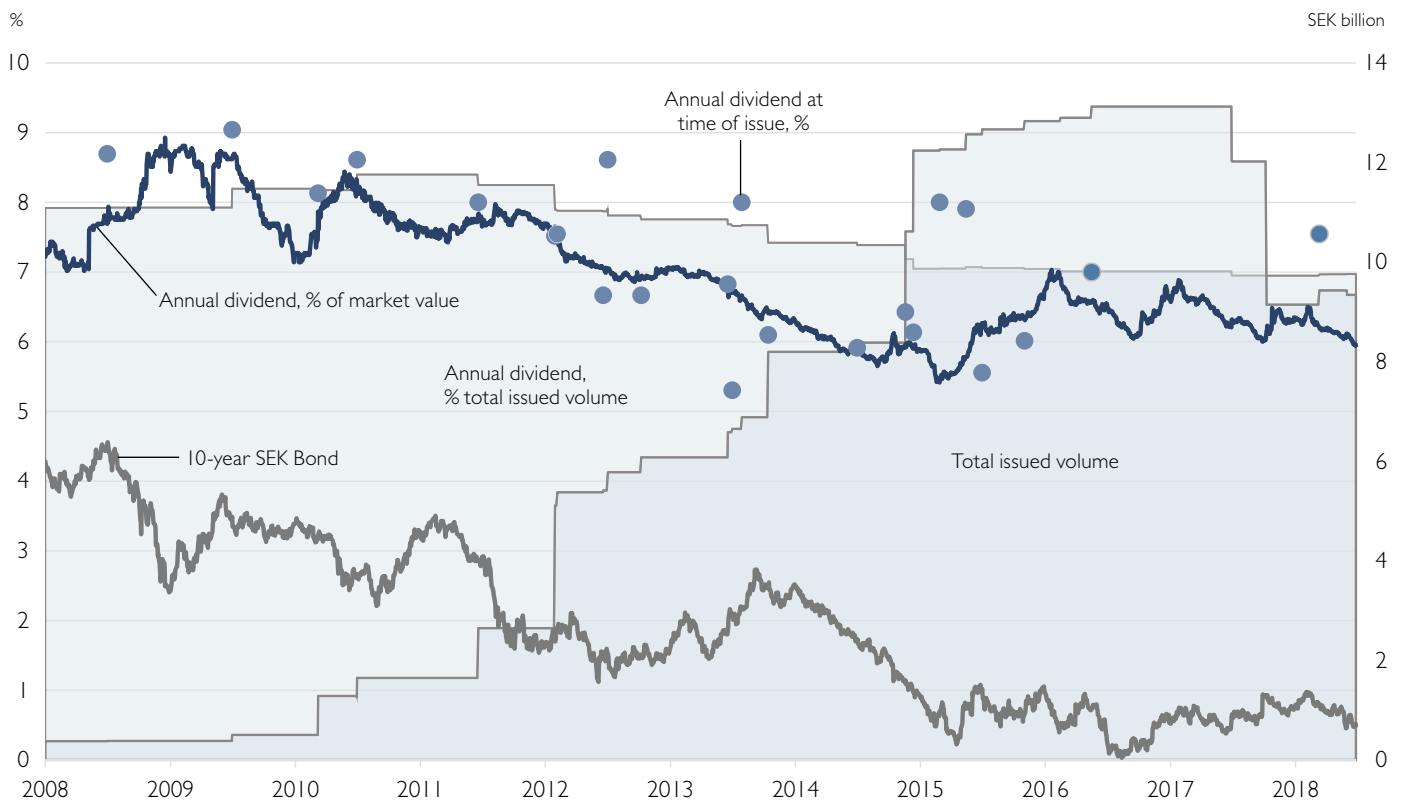


Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The market for property-related preference shares has been fairly uneventful during the first half of 2018, with the exception of a new issue by NP3 and a redemption by Oscar Properties. However, the secondary market is looking increasingly healthy, with an average dividend below 6 per cent.

Property companies' preference shares on Nasdaq Stockholm Main Market



Following a volatile year in 2017, where the market for property-related preference shares on Nasdaq Stockholm Main Market decreased by more than 30 per cent as Sagax and Balder redeemed a large amount of shares, the preference share market has been fairly stable in 2018.

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.

In addition, in June 2018, Oscar Properties issued SEK 32 million of its class A preference shares to Skandrenting.

On the other hand, on 27 June, Oscar Properties also approved the redemption of approximately SEK 137 million of its

more successful class B preference share, somewhat reducing the outstanding volume of preference shares on Nasdaq Stockholm Main Market. The class B preference share entails the right of the owner to request that the issuer redeem the share, a feature which the worse performing class A preference share lacks.

Furthermore, on 13 June, Sagax announced that it is issuing an additional SEK 302 million of its new high-yielding class D common share, an instrument that the company launched as an alternative to preference shares.

Alongside the fairly stable primary market, the secondary market has been strong in recent months. Although the secondary market for property-related preference shares took a substantial hit in the autumn

of 2017, as reports of postponed residential projects were circulated in the news, the secondary market has recovered considerably and the average dividend is currently below 6 per cent as of 27 June 2018.

Catella's view through the looking glass

The economic cycle is now entering its final phase. However, continuously positive credit sentiments indicate a strong demand for well-located properties in the major cities.

The Swedish equity market is a strong leading indicator of the CREDI Current Situation index for property owners. The equity market indicates that index levels will fall back somewhat, but remain above the 50-mark in the coming quarters. The strong credit sentiments are likely due to the large amounts of bonds issues by the major Swedish property companies over the past 12-18 months, which have freed up capacity in the banking system. However, the wide gap in access to credit between the large, well-established property companies and smaller investors will 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.

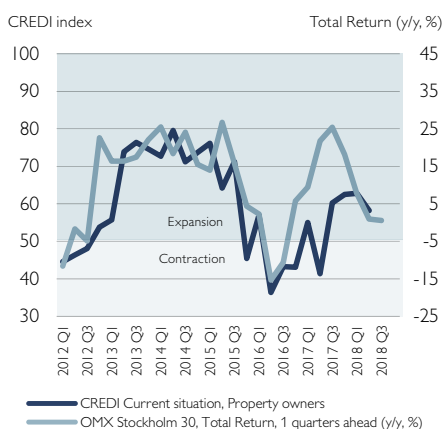
Catella expects condominium prices in Stockholm to fall by around 15 per cent from top to bottom (the price fall is around 9 per cent so far). Housing prices are a strong leading indicator of GDP growth, and the lower housing prices indicate falling residential investments and lower private consumption growth from the second half of 2018 and onwards.

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

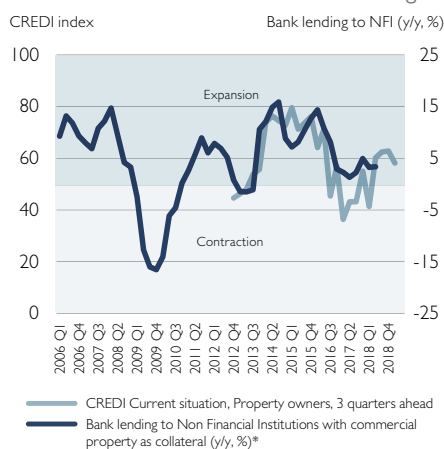
months, average yields for office properties have fallen in line with the transaction volumes. A reason for the yield decline is that a large share of the transactions lately have involved prime properties in the major cities, where yield levels are low. A number of large Swedish institutions have lately sold or are about to sell well-located office properties in Stockholm. Catella expects office rental growth in Stockholm to slow down or even turn negative from late 2018 due to increasing supply of newly built offices and slower GDP growth, while average yields for commercial properties are expected to increase (mainly by means of increasing yield spreads between A, B and C locations).

The underlying fundamentals for Swedish property, however, remain strong with continuously low or negative real interest rates, resulting in a strong investor demand from institutional and private investors.

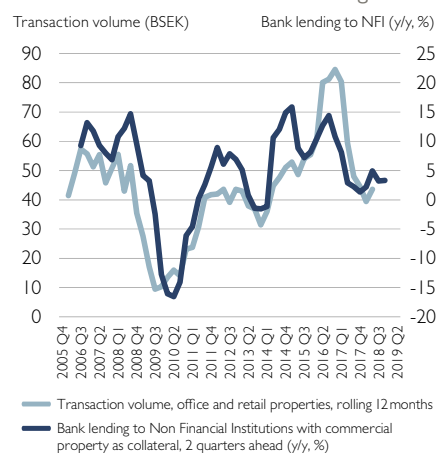
CREDI Current Situation and OMX Sthlm 30



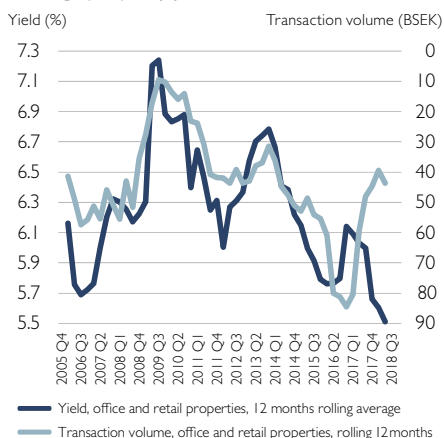
CREDI Current Situation and bank lending



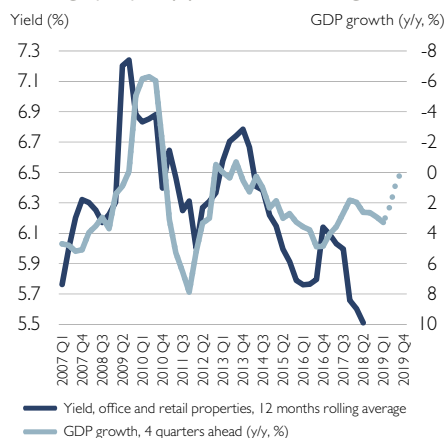
Transaction volume and bank lending



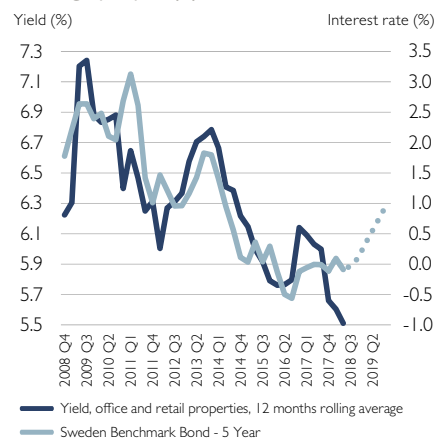
Average property yields* and transaction volume



Average property yields* and GDP growth



Average property yields* and interest rates



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

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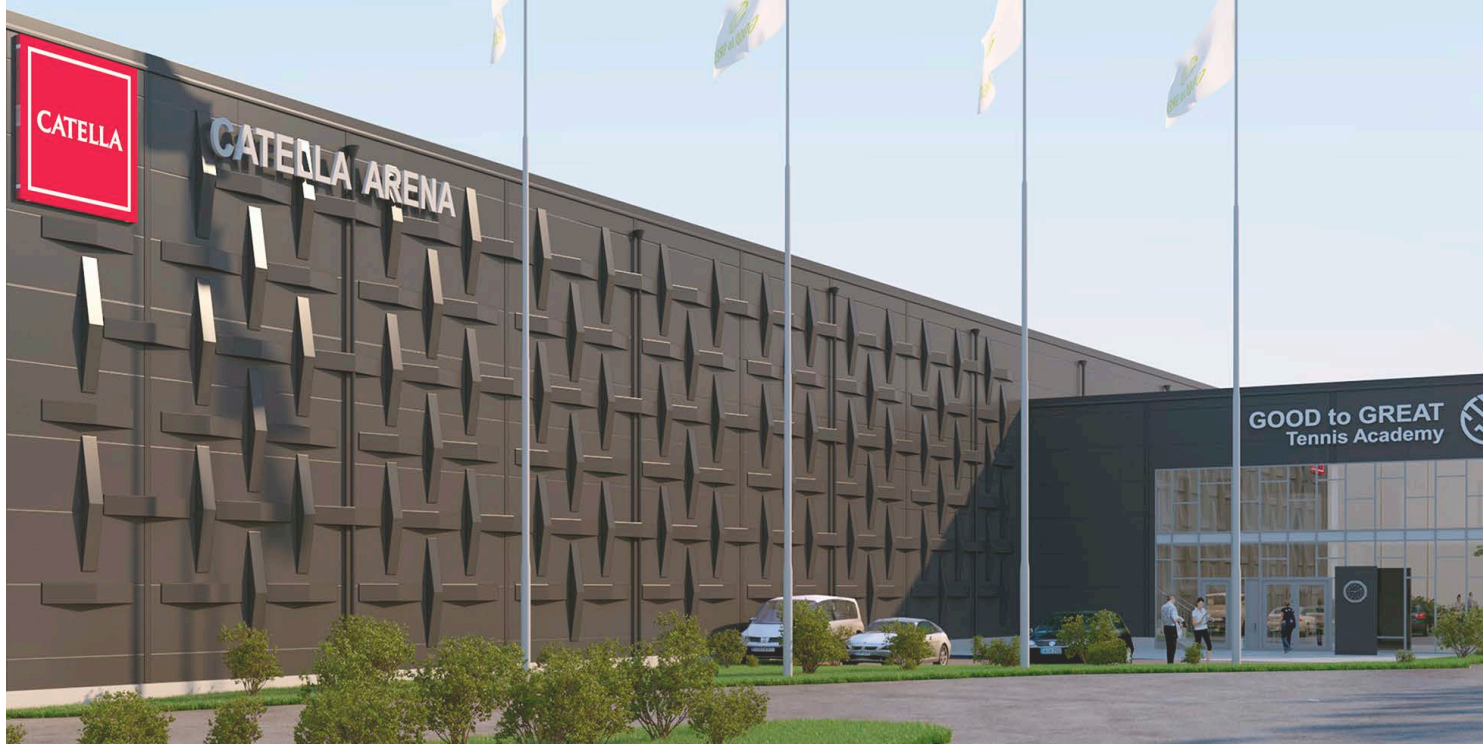
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