CATELLA

CREDI®
CATELLA REAL ESTATE DEBT INDICATOR

CREDI October 2018

Stable credit market despite negative sentiments among banks

In the October issue of CREDI, the Main index has fallen from 54.3 to 49.6, following three straight quarters with the Main index above the 50-mark. Property companies still have a positive view of the credit market, while banks are noticeably more cautious. Moreover, the bond market is showing clear signs of levelling out.

CREDI MAIN INDEX INDICATES A RATHER STABLE CREDIT MARKET

In the October survey of CREDI, the Main index fell from 54.3 to 49.6. This is preceded by three quarters of improving market sentiments, and indicates a stabilization in the credit market.

BANKS HAVE SHIFTED FROM POSITIVE TO NEGATIVE SENTIMENTS

Although the July survey of CREDI showed that banks had a more positive view of the credit climate than property companies, in the October survey banks are once again holding a more cautious view of the credit market than property companies do.

INTEREST RATES HAVE YET AGAIN FALLEN TO A NEW RECORD LOW

Once again, the average interest rate of listed property companies has fallen to a new record low. In the second quarter of 2018, the average interest rate fell to 2.1 per cent, which is the lowest rate observed in the history of CREDI.

PROPERTY SHARES ARE TRADING CLOSER TO UNDERLYING ASSETS

Although property shares are being traded at a discount for the third consecutive quarter, the stock market has recovered noticeably and is likely to trade at a premium in the next quarter.

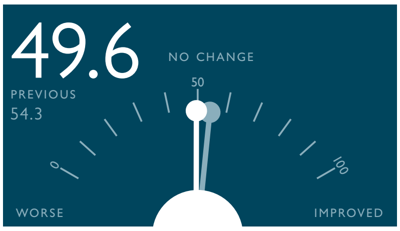
FURTHER SIGNS THAT THE BOND MARKET IS LEVELLING OUT

Following a record year in 2017, the bond market is showing signs of levelling out in 2018. The bonds' share of interest-bearing debt remains at 25.6 per cent for the second straight quarter, while the volume of outstanding bonds increased by merely 4 per cent.

STRONG SECONDARY MARKET FOR PREFERENCE SHARES

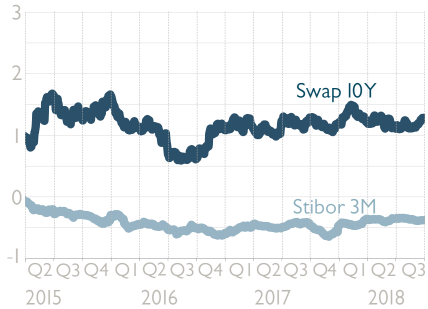
Property-related preference shares struggled in 2017, as the volume decreased by 30 per cent and share prices fell. However, the secondary market has recovered in 2018 with an average dividend of 6 per cent.

CREDI Main index



Banks	Corporates
43.8	55.4
52.5	56.1

Swedish key interest rates, 2015–2018. Per cent



Loan-to-value Q2 average	Interest rate Q2 average	Fixed credit term Q2 average	Fixed interest term Q2 average
52%	2.1%	3.5 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

Following three consecutive quarters of an improving market sentiment, the October survey of CREDI showed a slightly negative development where the CREDI Main index fell from 54.3 to 49.6. The Current Situation index remains strong, particularly thanks to positive sentiments among property companies.

Main index components

The CREDI Main index fell from 54.3 to 49.6 in the October survey of CREDI, following three straight quarters of an improving credit market. The development of the Main index indicates that respondents in the real estate industry expect the credit market as a whole to remain stable, albeit possibly worsening slightly in the coming months.

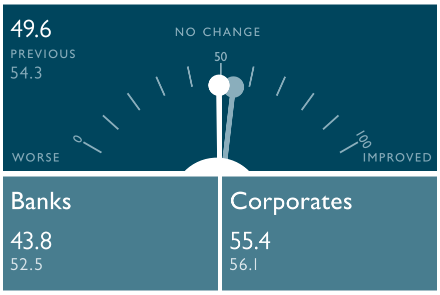
While the Main index is held back by the Expectation index, which has fallen below the 50-mark, the Current Situation index remains strong. At 53.7, the index is a reflection of a positive market sentiment over the past three months, in particular among property companies. The spread between the two indexes can be seen as a sign of pessimism with regard to the future development of the credit market for the real estate industry. Nevertheless, the spread between the current situation and expectations is lower than in previous quarters.

In the previous CREDI survey, carried out in July 2018, banks and property companies had aligned their views of the credit market considerably. Having differed by as much as 16.3 index points in September 2017, the gap had decreased to merely 3.7 index points. In the October survey, however, the gap has once again widened to 11.6 index points. As has been a noticeable trend throughout the history of CREDI, banks have a less positive view of the credit market than property companies.

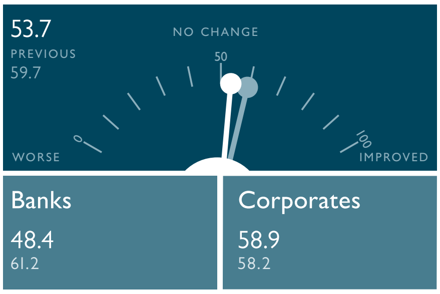
Sub-indices

Looking at the underlying sub-indices that make up the CREDI Main index, it shows that lowered credit margins and extended duration of loans have had a positive effect on the Current Situation index, while the Expectation index is held back by worse access to credit and increasing credit margins in the future. Leverage is expected to remain fairly unchanged.

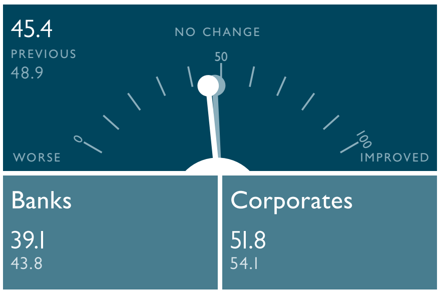
CREDI Main index



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

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.

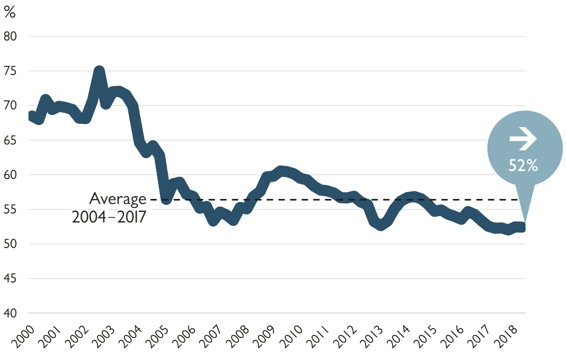
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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 interim reports for the second quarter of 2018 indicate that property companies have seen a slightly improved credit market, with lower interest rates and extended fixed credit terms.

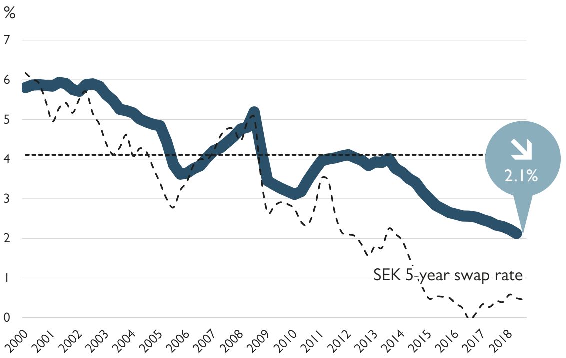
Listed sector Q2 average loan-to-value[1]



The loan-to-value of property companies listed on Nasdaq Stockholm Main Market remained at 52 per cent for the fifth consecutive quarter, and thus stays below the historical average of 56 per cent.

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

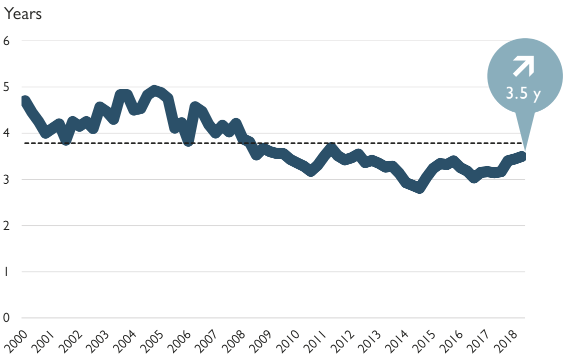
Listed sector Q2 average interest rate[2]



The average interest rate of listed property companies continues to fall. In the second quarter of 2018, the interest rate fell to 2.1 per cent, which is the lowest rate in the history of CREDI. Wallenstam and Fabege lowered their interest rates considerably, due to the expiration of expensive swaps, while Klövern's interest rate has increased following the company's acquisition of residential developer Tobin Properties.

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

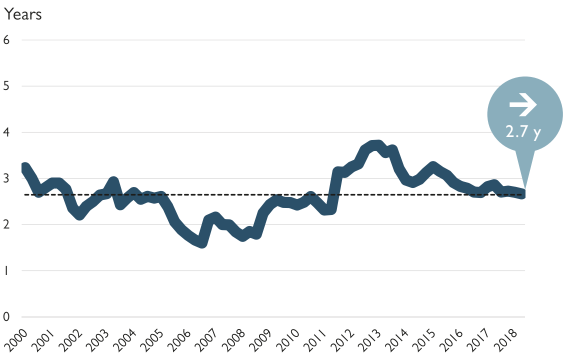
Listed sector Q2 average fixed credit term[3]



The average fixed credit term among listed property companies increased from 3.4 years to 3.5 years in the second quarter of 2018, slightly below the long-term average of 3.8 years. Around half of the companies extended their fixed credit terms during the quarter.

3 Average maturity referring to interest-bearing debt.

Listed sector Q2 average fixed interest term[4]



-------- Average 2000–2017

In the second quarter of 2018, the average fixed interest term among listed property companies remained at 2.7 years for the fourth consecutive quarter, 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 Q1 2000.

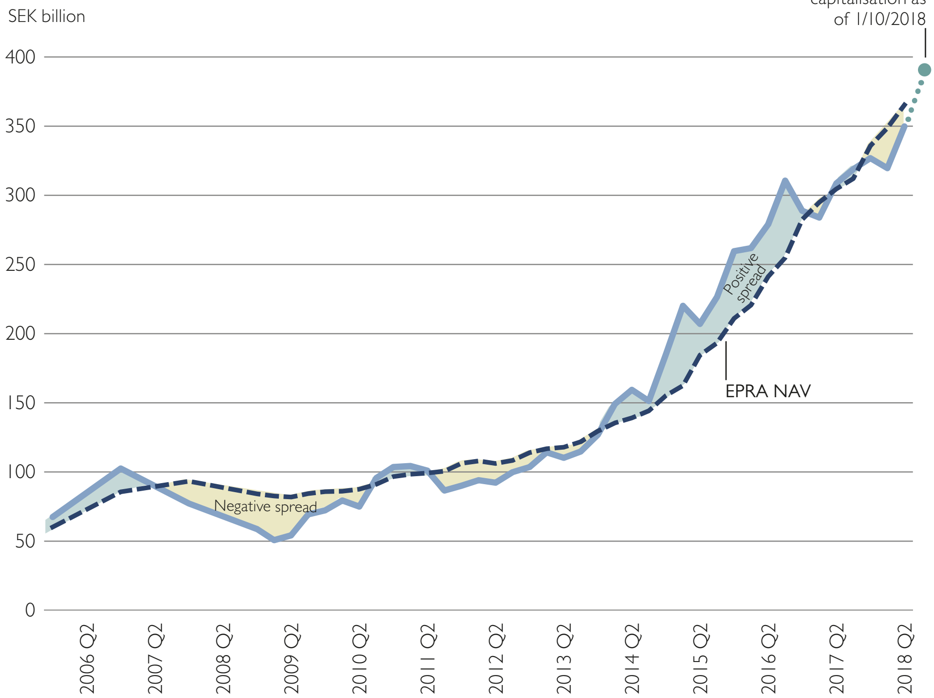
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Common shares

The second quarter of 2018 is characterized by a recovering stock market that is raising its valuation of the listed property companies' net operating income and underlying assets.

Shares in property companies on Nasdaq Stockholm Main Market traded at a slight discount at the end of the second quarter of 2018. Market capitalisation increased from SEK 320 billion to SEK 350 billion, while the property companies' EPRA NAV increased from SEK 349 billion to SEK 365 billion. As such, the market discount has decreased during the quarter. Furthermore, during the third quarter of 2018, market capitalization has increased considerably and has reached approximately SEK 389 billion as of 1 October 2018. This suggests that we might see a market premium at the end of the third quarter.

Premium or discount – market capitalisation and 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.

In the second quarter of 2018, the implicit yield of property companies on Nasdaq Stockholm Main Market decreased from 4.7 per cent to 4.5 per cent, following a quarter with strong performance on the stock market. Furthermore, due to an even stronger stock market during the third quarter, the year-to-date implicit yield has reached 4.3 per cent as of 1 October 2018.

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

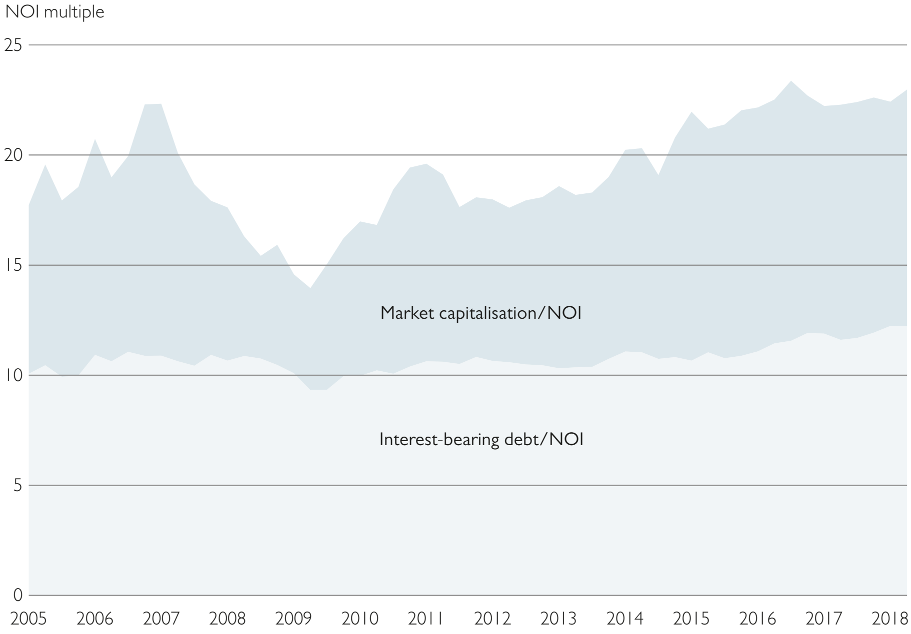
1) Market values 1/10/2018 and 2018 Q2 EPRA NAV.

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.

Interest-bearing debt remained at 12.2 times net operating income in the second quarter of 2018, while market capitalisation increased from 10.2 to 10.7 times net operating income. 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.

Interest-bearing debt and market capitalisation in relation to NOI



Note. Property companies on Nasdaq Stockholm Main Market.

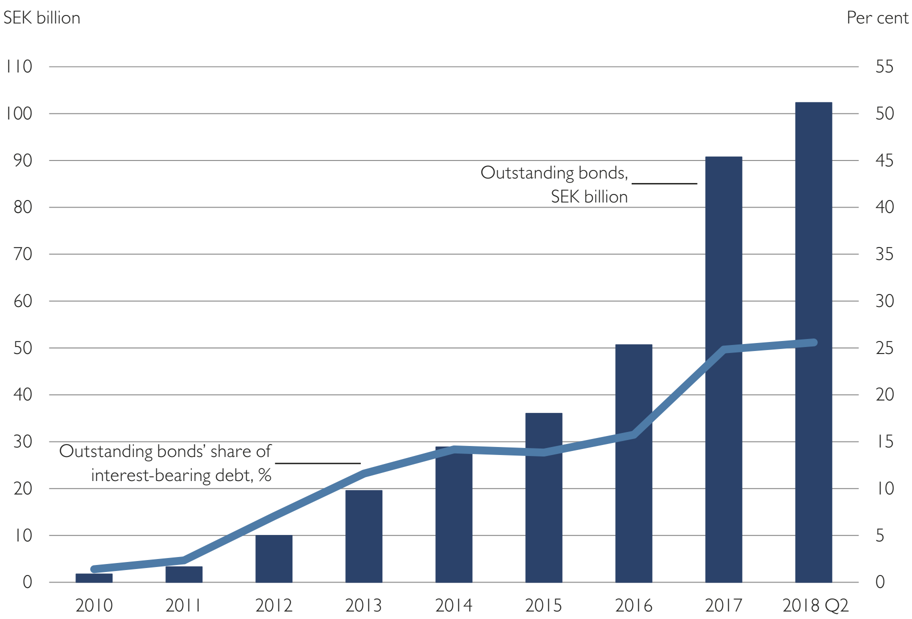
Bonds

Following a record year for corporate bonds in 2017, the bond market is showing signs of levelling out.

In 2017, corporate bonds became increasingly popular among property companies listed on Nasdaq Stockholm Main Market. During that year, the volume of outstanding bonds increased by 80 percent from SEK 50.7 billion to SEK 90.7 billion, while the bonds' share of interest-bearing debt increased from 15.7 per cent to 24.8 per cent.

However, in 2018 the bond market is showing signs of levelling out. In the first quarter of 2018, the outstanding volume increased by 8 per cent to SEK 98.2 billion, while in the second quarter the volume increased by merely 4 per cent to SEK 102.3 billion. Furthermore, corporate bonds' share of interest-bearing debt has remained at 25.6 per cent for the second consecutive quarter.

Outstanding bonds

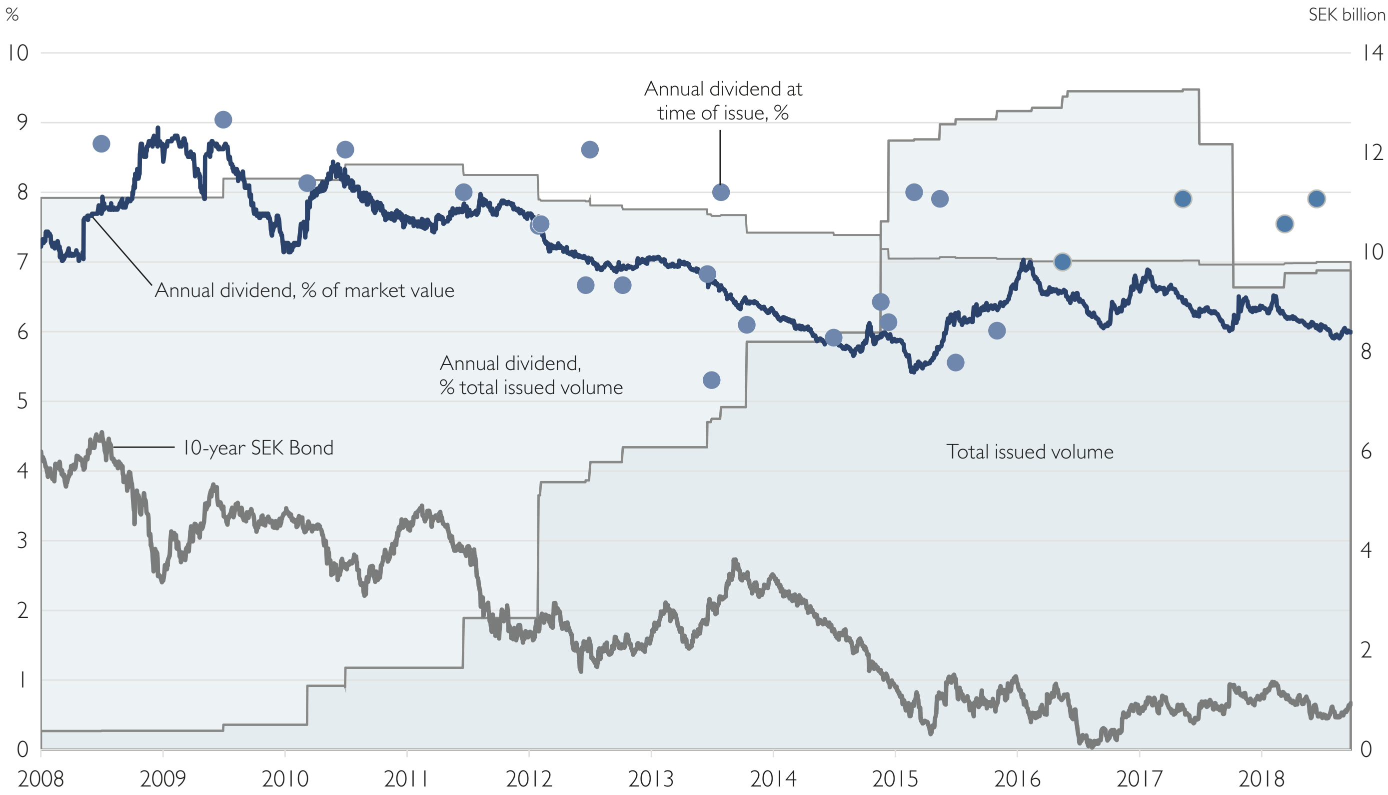


Note. Property companies on Nasdaq Stockholm Main Market.

Preference shares

The secondary market for property-related preference shares remains healthy in the third quarter of 2018, with an average dividend at approximately 6 per cent.

Property companies' preference shares on Nasdaq Stockholm Main Market



The market for property-related preference shares on Nasdaq Stockholm Main Market appeared to take a substantial hit in 2017. During the year, the outstanding volume decreased by 30 per cent as Sagax and Balder redeemed a large amount of preference shares. These companies sought to replace their preference shares with alternative sources of capital. Sagax issued a new high-yielding class D common share while Balder issued hybrid bonds. These redemptions were seemingly made in order to improve the companies' credit ratings. For example, Sagax received its investment grade rating from Moodys in September this year.

However, the preference share market appears to have become healthier in 2018. In the spring of 2018, NP3 issued approximately SEK 288 million in new preference shares. In addition, NP3 has recently signalled that they are issuing an additional SEK 304 million worth of preference shares in the autumn of 2018.

Furthermore, in June 2018, Oscar Properties increased the outstanding volume of its class A preference share by approximately 50 per cent. On the other hand, Oscar Properties also approved the redemption of approximately SEK 137 million of its class B preference share, somewhat evening out 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.

Alongside the fairly stable primary market, the secondary market has been strong throughout the year. The average dividend of property-related preference shares has fallen from 6.4 per cent at the turn of the year to approximately 6 per cent as of 1 October 2018.

Catella's view through the looking glass

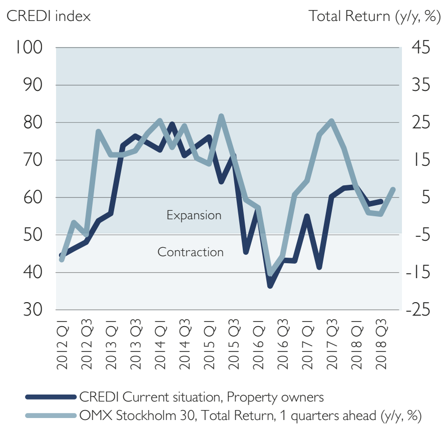
The economic cycle is entering its final phase and the credit sentiments among banks have weakened significantly. However, positive credit sentiments among property companies indicate a strong demand for well-located properties in the major cities for some time to come.

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 remain above the 50-mark in the coming quarters. However, the credit sentiments among banks have weakened significantly lately, which might impact how property companies view the credit market. Furthermore, 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.

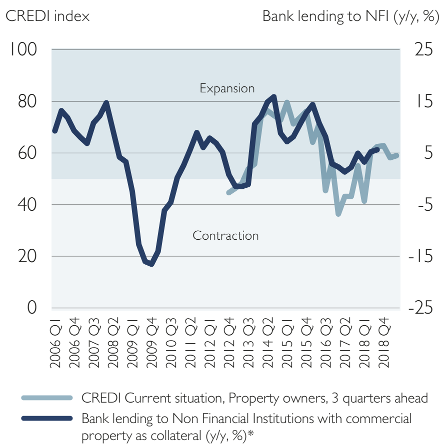
In 2018, Swedish service pension funds have gone from being net buyers to net sellers in the property market, and have in particular been selling off office assets in Stockholm. Several Swedish institutional investors are currently working on lowering the risk in their portfolios by selling cyclical assets. In the last 12-18 months, the market for prime office properties in larger cities has mainly been driven by private companies, listed property companies and international funds. An important reason for Swedish listed property companies' recent competitiveness in bidding processes is their strong performance on the stock market in the past 6–9 months as well as having access to extremely affordable debt financing.

Taken as a whole, the extremely low interest rates are keeping investors far out on the risk scale. The direction going forward is gradually higher rates from the large central banks, who will also reduce their purchasing of securities (resulting in less liquidity in the financial systems). For property investors, this will entail slightly higher market interest rates and a wider interest rate gap between companies with different risk levels, as bond investors are demanding a higher return for risk. As such, it appears that the challenge going forward will be that financing becomes more expensive for certain actors while rents have a weaker development and the risk of vacancies increases, due to an overall weaker economy.

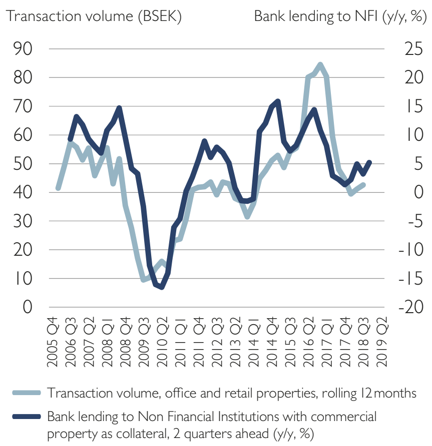
CREDI Current Situation and OMX Sthlm 30



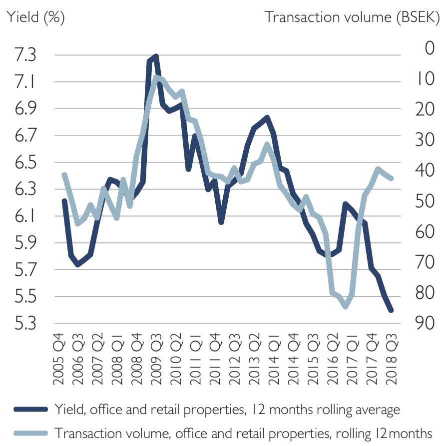
CREDI Current Situation and bank lending



Transaction volume and bank lending

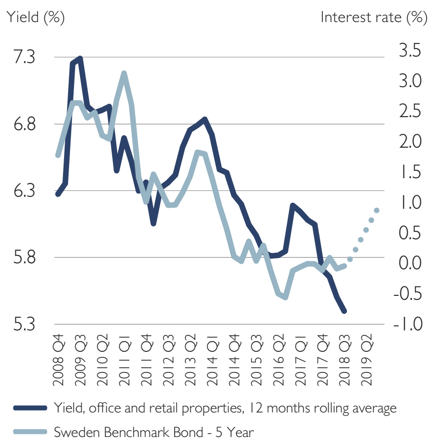


Average property yields* and transaction volume



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.

DISCLAIMER

This publication is provided for information purposes only and is not intended as an offer or solicitation for the purchase or sale of any financial instrument in any jurisdiction. The information contained herein has been obtained from public sources and through a quarterly current and forward-looking survey and is believed by Catella Corporate Finance to be reliable but no representation is made as to its accuracy or completeness. The views reflected herein are subject to change without notice.

Catella Corporate Finance will not update, modify or amend the information in this publication or otherwise notify a reader thereof in the event that any matter stated herein changes or subsequently becomes inaccurate. Any references to past performance are not a reliable indicator of future performance.

Neither Catella Corporate Finance, nor any member of the Catella Group, accept any liability whatsoever for any direct or consequential loss arising from any use of this publication or its contents. Recipients of this publication outside Sweden should take note of and observe any applicable legal requirements.

The figures in this publication have been rounded, whereas calculations have been conducted without rounding. Thus, certain tables might appear to be incorrectly aggregated.

This disclaimer is governed by Swedish law.

Contacts

Martin Malhotra
Partner
Direct: +46 8 463 34 05
SMS: +46 70 311 34 05
martin.malhotra@catella.se

Max Doherty
Associate
Direct: +46 8 463 33 73
SMS: +46 72 207 10 27
max.doherty@catella.se

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

Catella is the main proud sponsor of Good to Great Tennis Academy's new arena i Danderyd.

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.

HQ: Birger Jarlsgatan 6, Stockholm info@catella.se
www.catella.com