CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

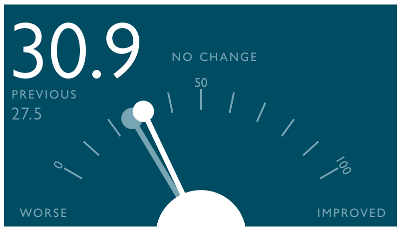
CREDI September 2022

CREDI index remains severely depressed although slightly improved from previous quarter

In the September issue of CREDI the Main index remains at a historically low level, although it improved slightly from 27.5 in the previous quarter to 30.9. The low level of the CREDI index mirrors an equally stressed situation in the unsecured bond market, where credit margins remain unprecedentedly high.

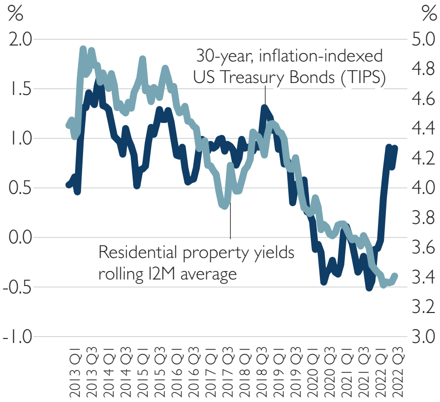
- The CREDI Main index registered one of its lowest readings ever at 30.9, which nonetheless is an improvement compared to the previous quarter.
- The unusual situation portrayed by the previous CREDI index remained similar in this edition as the subindex of Current Situation continued to be as low as Expectations (30.0 versus 31.8), indicating a prolonged slump.
- There has been a lot of volatility in the interest swap market since the last CREDI. The dramatic rise in swap rates reversed in the middle of June and a sharp decline ensued taking the 5-year rate from 3.15 per cent to 2.25 per cent in early August. This paved the way for broad rebound in the equity market.
- Bond credit margins continued to increase until mid June and have since remained at unsustainably high levels.
- In the property transaction market, both the number of deals and the average deal size remained at an absolute historic peak during the summer. The rolling 12-month transaction volume reached SEK 248 billion in August. The high inflation rate is pushing up financing costs, which in turn is creating willing sellers on the property market.
- Catella expects central banks to tighten too little and too late to rein in inflation. As a result, long-term inflation expectations will increase, and long-term real interest rates will decline again. This is a rather good macro environment for real assets like property.

CREDI Main index



Banks	Corporates
20.7	41.1
17.7	37.2

Real interest rates and average residential property yields



Loan-to-value Q2 average	Interest rate Q2 average	Fixed credit term Q2 average	Fixed interest term Q2 average
↗ 54%	↗ 2.0%	↗ 3.4 y	↘ 2.8 y

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

The CREDI Survey

In the September issue of CREDI the Main index remains at a historically low level, although it improved slightly from 27.5 in the previous quarter to 30.9. As in the previous CREDI, is it higher credit margins and decreasing availability of credit are the main drivers for the low level of the index.

In the September issue of CREDI, the Main index improved from 27.5 to 30.9. Current Situation only improved from 27.7 to 30.0 while Expectation improved a bit more (from 27.2 to 31.8). The higher level of Expectation entirely derive from borrowers which think the market will improve somewhat in contrast to the banks which are equally pessimistic about Current situation and Expectation. As previously the banks are overall much more pessimistic with a sub-index level of 20.7 and the borrowers are more positive with a sub-index level of 41.1.Banks have always responded more defensively to the CREDI survey, but the difference between banks and borrowers tend to be 5–15 points rather than circa 20 points.

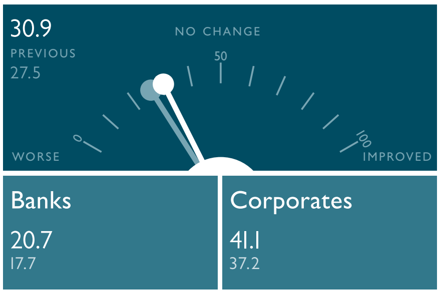
The largest contributor to the low level of the CREDI index relates to the markets firm belief that credit margins have increased and will increase further. The second most impact on the index was market participants view, that the availability of debt has decreased. Both these readings mirror the developments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

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

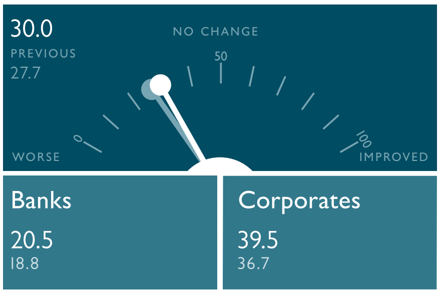
SUB-INDICES

The CREDI Main index is made up of eight underlying sub-indices. According to respondents in the September edition of 2022, credit availability, leverage, and duration are expected to decrease. The banks are especially bearish as they all believe that the credit margins will increase the coming three months.

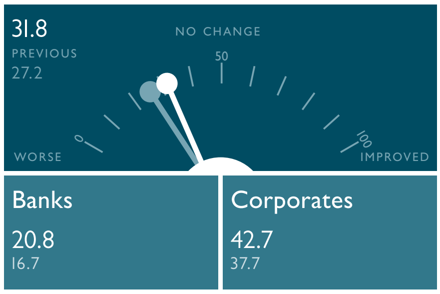
CREDI Main index



Current Situation



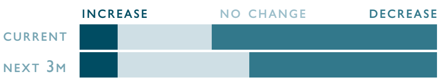
Expectation



The CREDI sub-indices present survey data question by question. The bars represent the distribution of actual answers per question, separated into the components Current Situation and Expectation for the coming three months.

CREDI Sub-indices

CREDIT AVAILABILITY



LEVERAGE

CREDIT MARGINS

DURATION

ABOUT THE CREDI SURVEY

CREDI is a market sentiment indicator for the Swedish real estate debt market. The indicator is based in part on a quarterly current and forward-looking survey of Swedish listed property companies, and banks providing real estate financing on the Nordic market. This part of the indicator is called the CREDI survey.

The CREDI survey contains four questions about recent changes in credit availability and credit conditions, and four questions about expectations regarding changes in credit availability and credit conditions in the next three months.

The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 50 index points. Consequently, the turning point in sentiment is 50 and any reading below this level indicates more difficult financing conditions while any reading above indicates less difficult financing conditions.

Separate indices are aggregated per respondent category. The Main index and its components are then computed as an unweighted average of these two categories – ensuring that the answers of borrowers and lenders are equally weighted in the Main index.

The CREDI Indices

There have been minor changes within the CREDI Indices during the recent quarters/months. Most notably was the slight increase in the average interest rate.

LISTED SECTOR Q2 AVERAGE LOAN-TO-VALUE1

During the second quarter of 2022, there were only minor changes within the CREDI Indices as loan-to-value slightly increased to 54 per cent. The loan-to-value level remained fairly stable as the appraisal value of the property portfolios were not affected by the market turmoil in the same way as listed financial assets.

LISTED SECTOR Q2 AVERAGE INTEREST RATE

The average interest rate increased to 2.0 per cent, an increase corresponding to approximately 22 basis points compared to the previous period. Currently, Wihlborgs and Hufvudstaden both have industry-leading average interest rates at 1.35 and 1.40 per cent respectively. Genova remained as the company with the most expensive financing at 3.40 per cent, an increase of approximately 73 basis points compared to the last period. Fixed credit term slightly increased from 3.2 to 3.4 years. Fixed interest term slightly decreased from 3.2 to 3.0 years. Overall, there have been minor changes within the CREDI Indices during the recent quarters/months.

ABOUT THE CREDI INDICES

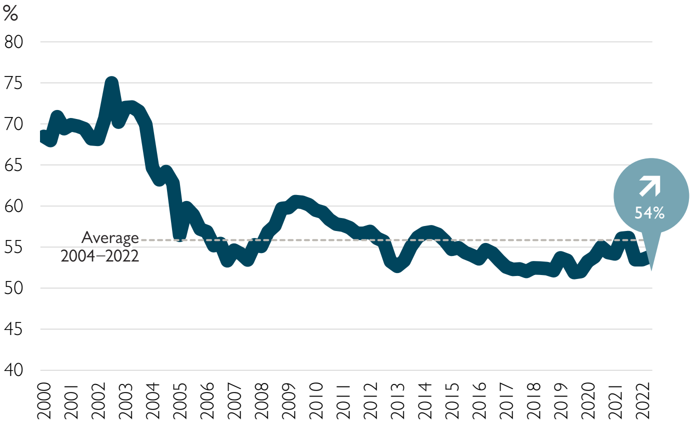
CREDI is based in part on a set of indices illustrating the aggregate change in leverage, duration and cost of debt for the Swedish listed property sector.

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.

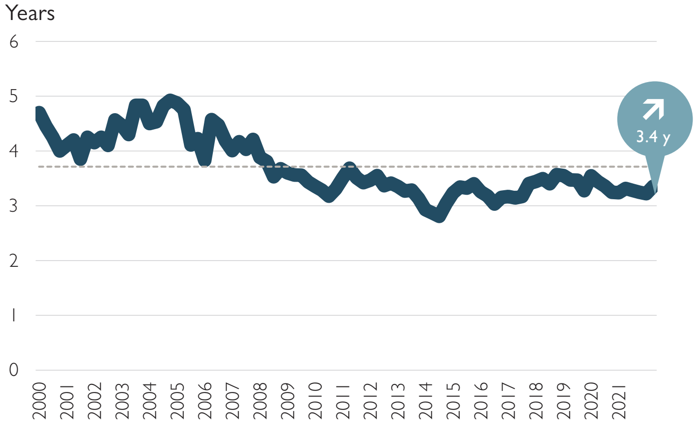
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

Loan-to-value[1]



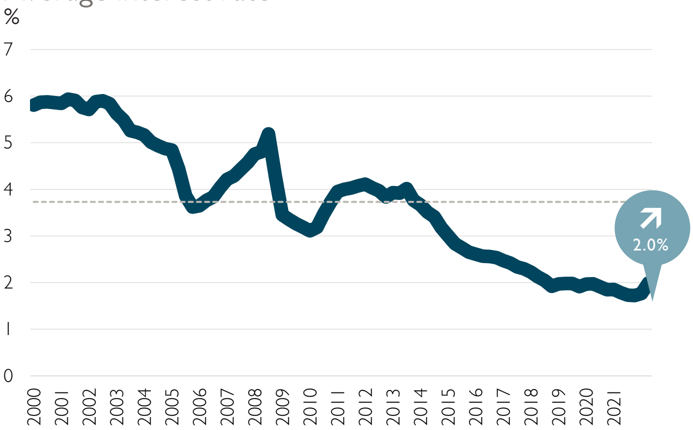
[1] Interest-bearing debt on property, excluding cash, divided by property value.

Fixed credit term[3]



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

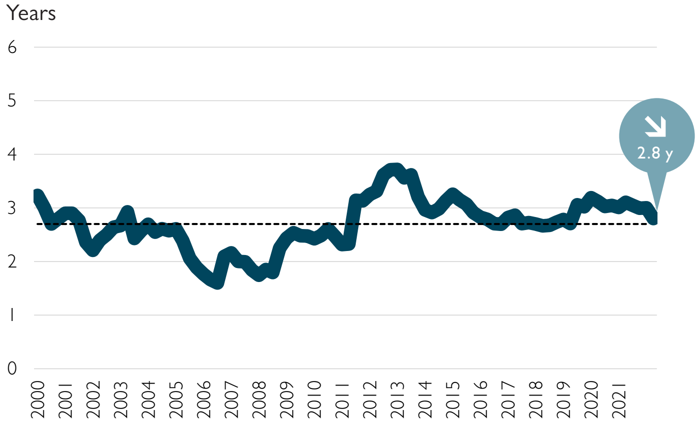
Average interest rate[2]



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

-------- Average 2000–2022

Fixed interest term[4]



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

Debt market

Our October 2021 prediction that we would see a turn of the tide in interest and credit markets proved to be correct. Both credit margins in the bond market and swap rates have increased dramatically since the beginning of the year, albeit for slightly different reasons.

The increases in the interest rate swap markets have been dramatic since February. The 3-year and 5-year rates in the SEK market have increased with 2.5 per cent and 2.3 per cent respectively and are both now at around 3.0 per cent. The market is pricing in a STIBOR 3M rate above 3.0 per cent for much of 2023 and 2024, which should be compared with STIBOR 3M being as low as 0.1 per cent earlier this year.

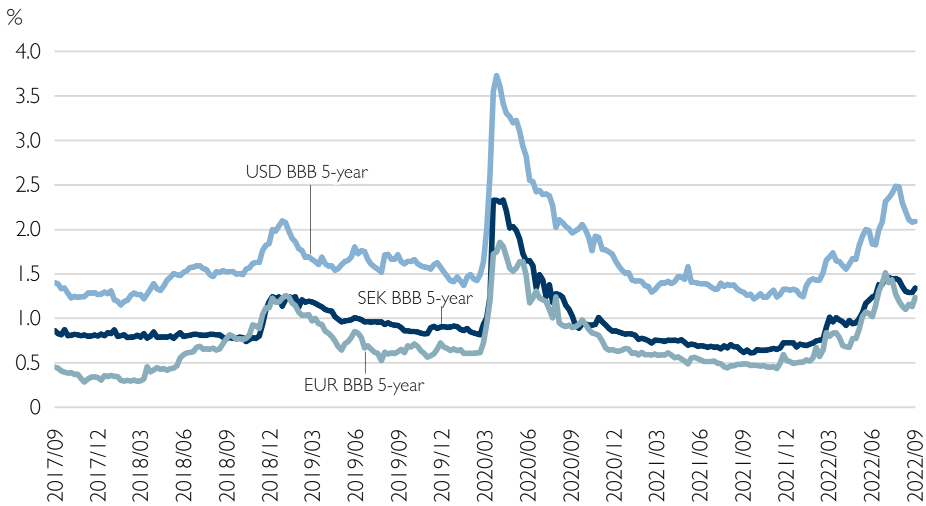
The effect of the elevated levels in the swap market is compounded by increases in the interest cost elsewhere. Margins in the bank loans market have evidently increased as the CREDI index clearly indicates. The anecdotal evidence from Catella Corporate Finances' ongoing mandates in the property transaction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

The shift in the capital markets is however much in line with the outcome of CREDI index. Volumes of new bond issues have decreased markedly compared to last year from February onwards. Bond issues from Swedish real estate companies in the euro market have more or less ceased altogether, which is concerning given how reliant some of Sweden´s larger corporates have become on this market. Issuing volume in the SEK market is down as well. Since May, basically only real estate issuers backed by the AP funds have been able to tap the bond market in large volumes. The listed real estate issuers with BBB ratings have however not been able to access the bond market to the same degree. However, Cibus, which don't have a rating, successfully issued a SEK 750 million bond at 595 basis points plus STIBOR.

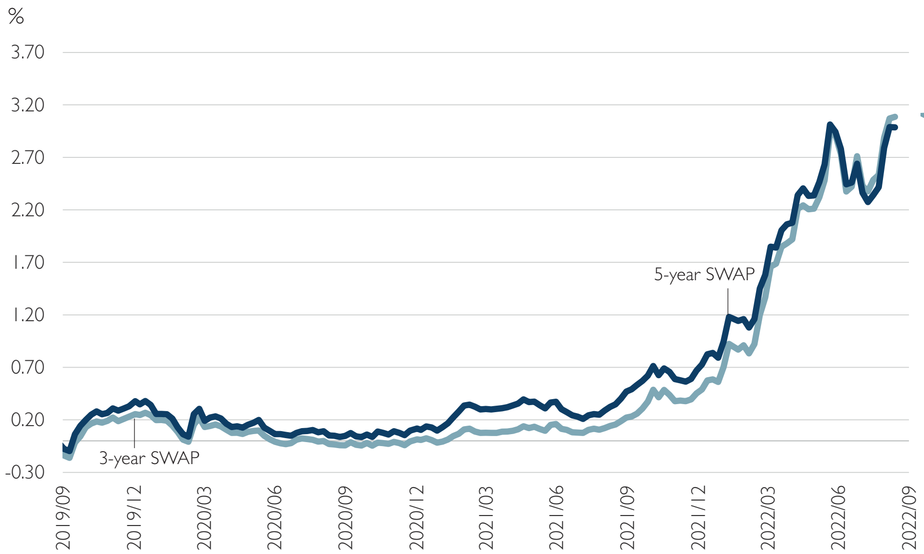
In early 2021 the credit spreads for BBB issuers (within real estate) for five year duration were around 100 basis points. In April 2022 the same issuers were selling bonds at around 200 basis points for the same duration, while presently these bonds are traded at around 350 basis points.

The increase in credit margins is a global phenomenon and connected to the reversal of the big central banks QE. This increase was aligned with Catella's previous prediction, a prediction made in the autumn of 2021 and given that QE is in all likelihood history, they will continue to do so.

Credit margin



3- and 5-year SWAP rates



NOTE

The 3-year SWAP rate is higher than the 5-year rate due to an almost world wide inversion of the yield curve

Common shares

The decline in market capitalization for the property-related shares on Nasdaq Stockholm Main Market has resulted in the largest discount to NAV recorded in over twelve years and is now trading at a discount of approximately 29 per cent.

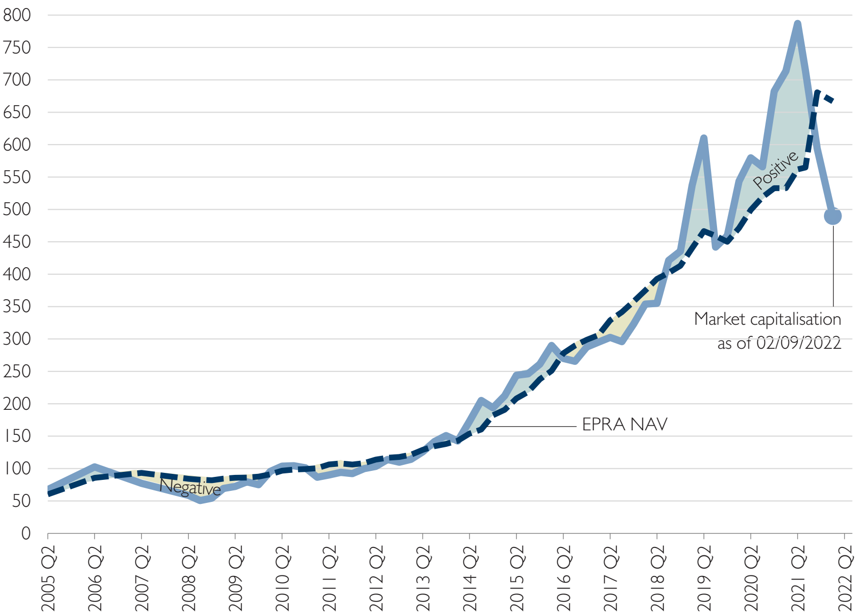
The market cap for the listed property companies reached an all time peak in November 2021. However, during the beginning of the second quarter of 2022, the property-related shares on the Nasdaq Stockholm Main Market experienced a correction phase and the market capitalization fell by approximately 20 per cent. This decline has continued and as of 02/09/2022 the market capitalization of the property-related shares on the Nasdaq Stockholm Main Market was recorded at SEK 489 billion, down almost 20 per cent compared to the last quarter.

Notably, many of the property-related shares reached an all time high before the end of the fourth quarter 2021, hence, the decline was arguably more severe than portrayed by the quarter-to-quarter perspective. The decline of the market capitalization has, among other things, resulted in the largest discount to NAV recorded in over twelve years. As of 02/09/2022 the shares on listed market for property-related shares on the Nasdaq Stockholm Main Market traded at discount to NAV of approximately 29 per cent.

As a result of the of the market capitalization declining, the implicit yields increased further to 4.5 per cent, corresponding to an increase of almost 60 basis points compared to the previous reading. As both financing and building materials have and are expected to become more expensive, the market capitalization might further decrease, increasing the implicit yield even more.

Premium or discount – market capitalisation as share of EPRA NAV

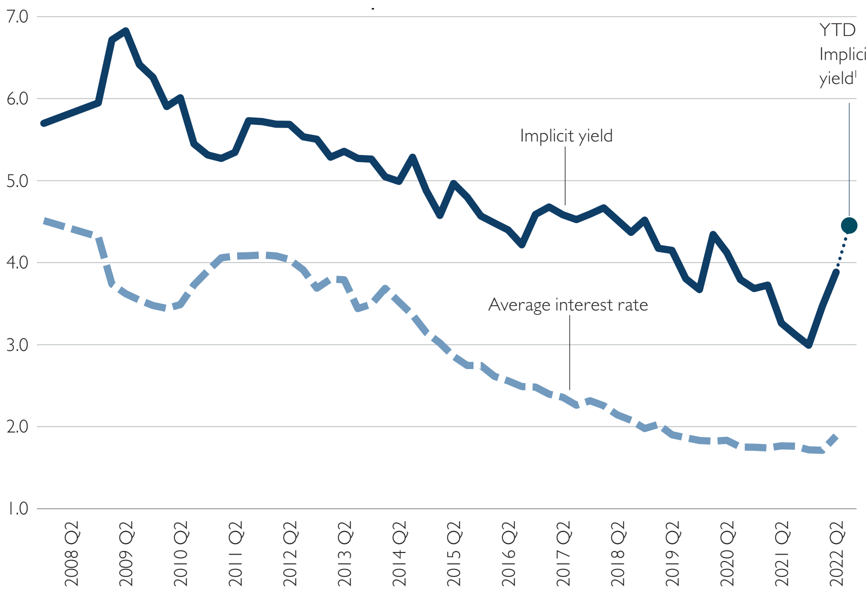
SEK billion



Note. Property companies on Nasdaq Stockholm Main Market.

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

Per cent



[1] Market values 02/09/2022 and Q2 2022 EPRA NAV.

Note. Property companies on Nasdaq Stockholm Main Market. EPRA NAV includes a 25 per cent deduction for deferred tax, now corresponding to 5.5 per cent. Market values 02/09/2022 and Q2 2022 EPRA NAV.

Alternatives

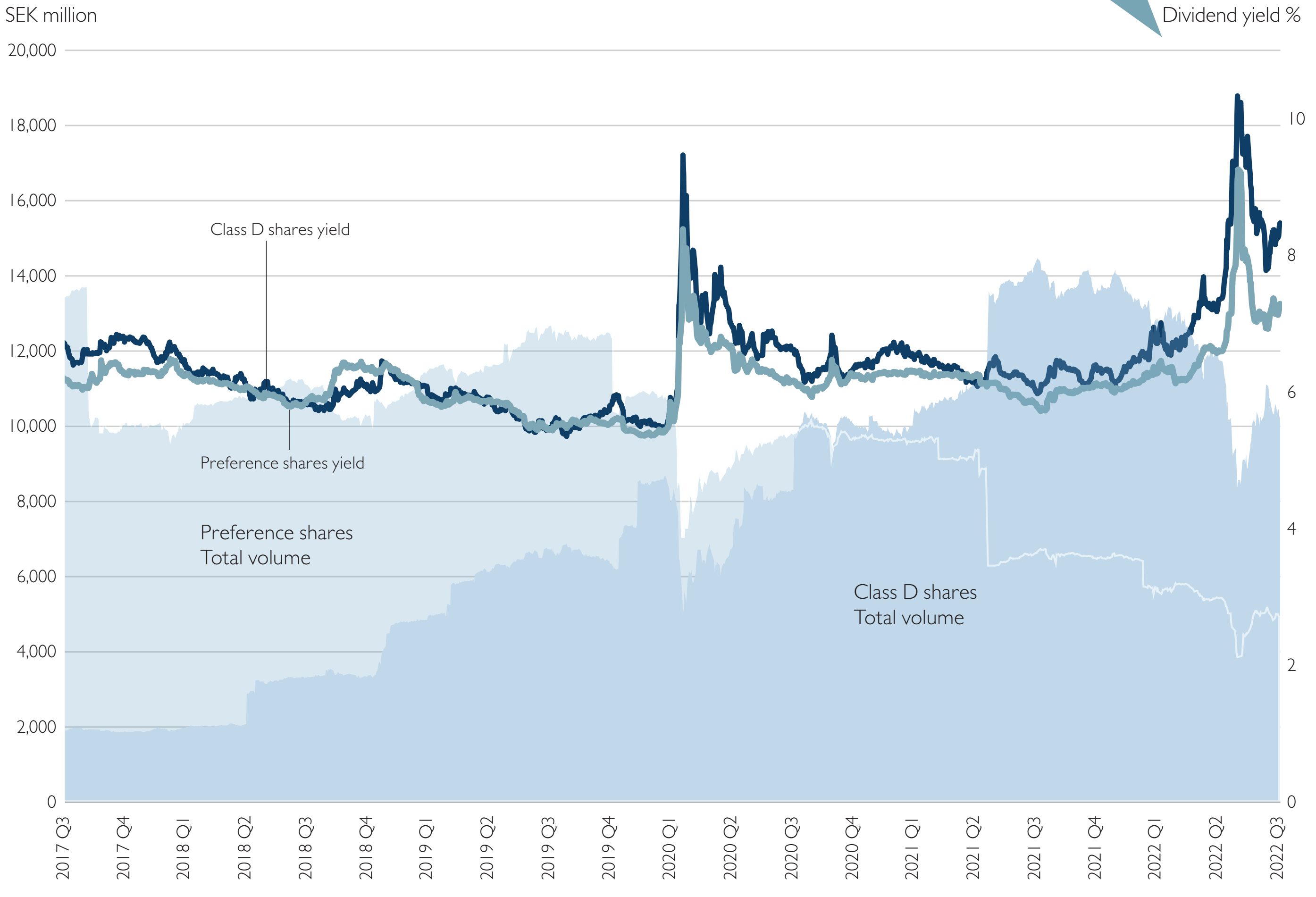
The trend of favoring class D common shares continues.

The secondary market for property-related alternative equity shares continued to decrease during the second quarter of 2022. As of 02/09/2022 the average dividend yields for preference shares and Class D common shares were recorded at 8.5 and 7.3 per cent respectively, both increasing. Thus, the yield spread between the two share classes has increased to around 120 basis points which is higher than the three-year average of around 20 basis points. Notably, Class D common shares increased by almost 190 basis points compared to the last quarter.

As described by the graph, the Class D common shares have become increasingly popular over the preference shares. Arguably this is due to the real estate companies wanting to optimize their balance sheet as preference shares initially were regarded as equity by rating agencies, however, now is considered to be equally part equity and debt. Thus, many real estate companies have made the assessment that the preference share has played its role as a form of financing.

NOTABLY, CLASS D COMMON SHARES INCREASED BY ALMOST 190 BASIS POINTS COMPARED TO THE LAST QUARTER.

Historical yield and volume – alternative equity shares



Source: Catella, annual reports, Nasdaq.

Catella's view through the looking glass

Both the number of deals and the average deal size remained at an absolute historic peak during the summer. The rolling 12-month transaction volume reached SEK 248 billion in August. The high inflation rate is pushing up financing costs, which in turn is creating willing sellers on the property market.

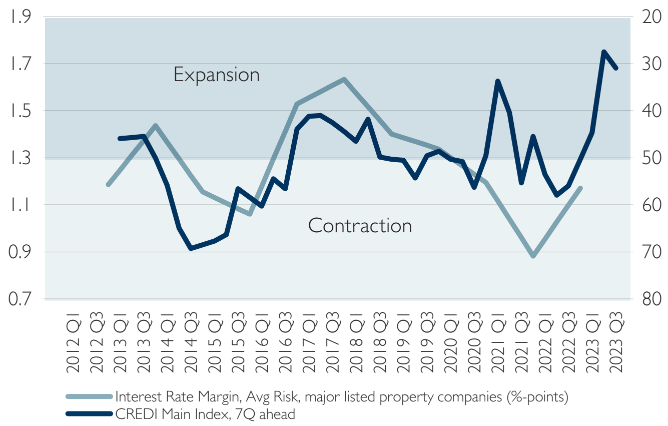
The Swedish economy will slow down significantly during coming quarters and enter a recession. The economic growth will fall below the zero-mark year-on-year during the fourth quarter 2022 and then go further down into negative territory in 2023. According to Catella's main scenario, stagflation (the combination of low economic growth and high inflation) is the most likely scenario for the coming years. In the short term, inflation will likely fall back significantly due to lower demand. However, as soon as demand returns, the supply restrictions will quickly drive up inflation again. There is a high risk that the debt load collapses, and we end up in a global recession and credit crunch. Catella believes that keeping up economic growth will be seen as more important for central banks than inflation.

Credrit spreads for several of the large Swedish listed property companies now stand in the interval 300–700 basis points on the risk free interest rate (for bonds maturing in 2023–2024). There has, however, been a slight recovery during the summer. The development during the autumn 2022 on the Swedish corporate bond market will be instrumental for the development on the transaction market.

Short-term interest rates will increase fast during coming quarters as the Riksbank increases the repo rate to around 1.75–2 per cent in late 2022. It is likely long-term nominal interest rate will temporarily fall back somewhat again as the Swedish economy enters a recession. However, long-term interest rates will follow a long-term increasing trend during coming years due to increasing inflation. The increasing financing costs have already started to push up property yields in ongoing transactions. However, most of the listed property companies look cheap in relation to their net asset values (NAV). There are now major discounts in relation to net asset value (NAV) for most of the Swedish listed property companies. Even more interesting is the current equity pricing in relation to the expected NAV in 12 months' time (in the third quarter 2023). Most of the companies are very cheap in relation to the expected forward-looking NAV too.

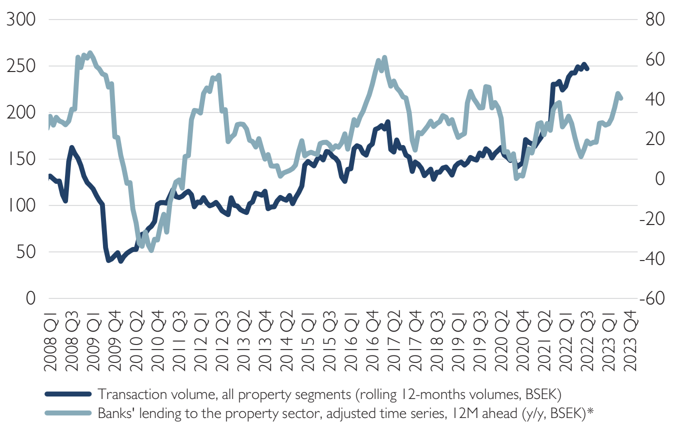
Average interest rate margins and CREDI Main index

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



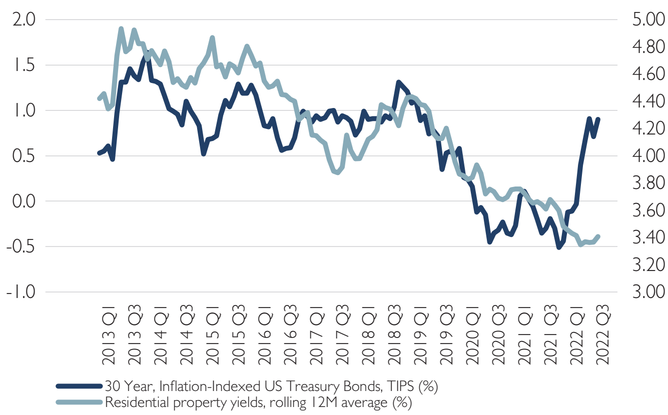
Transaction volume, bank lending commercial property

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



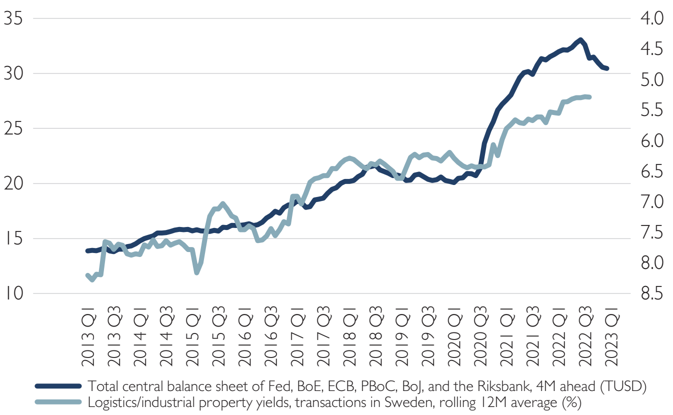
Real interest rates and residential yields

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



Central bank balance sheet[3] and logistics yields

Balance sheet (TUSD) 4M ahead Average log./ind. yield (invert. scale, %)



Source: Catella, SEDIS and FactSet

[1] Calculated interest rate margins based on 3-year interest rate/maturity. Average figures for Atrium Ljungberg, Balder, Castellum, Catena, Corem, Diös, Fabege, Fastpartner, Hufvudstaden, Klövern, Kungsleden, Sagax, Wallenstam and Wihlborgs.
[2] The bank lending is adjusted for irregularities and changes in definition in the underlying data.
[3] Total central balance sheet of Fed, BoE, ECB, PBoC, BoJ, and the Riksbank, 4 months ahead.

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

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CATELLA

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