CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

CREDI March 2017

Property companies view credit market positively

In the March issue of CREDI, property companies are viewing the credit market increasingly more positively, while banks have adopted a more negative view of the market. Although the market is still in contraction, the CREDI Main index has increased to 46.5, which is its highest score since September 2015.

THE CREDI MAIN INDEX IMPROVED DURING THE PAST THREE MONTHS

The property debt financing market is still in contraction, but the CREDI Main index has improved, going from 44.4 to 46.5. This is the highest score since September 2015.

CORPORATES HAVE A POSITIVE VIEW OF THE CREDIT MARKET

Having agreed on the state of the credit market for several quarters, with the December survey exhibiting the strongest consensus in CREDI history, the opinions of banks and corporates diverged in the March survey. Banks have become more negative towards the credit market, while corporates are increasingly positive.

CREDIT AVAILABILITY HAS IMPROVED

Nearly all property companies agree that access to financing has improved in the past three months, which has helped increase their CREDI Main index.

MARKET PREMIUMS HAVE FALLEN SIGNIFICANTLY...

During the fourth quarter, the market capitalisation of listed property companies has fallen considerably while asset values increased, causing market premiums to nearly evaporate.

...AND IMPLICIT YIELDS ARE UP

Following the fall in property companies' market capitalisation, the average implicit yield has increased to its highest level in more than a year.

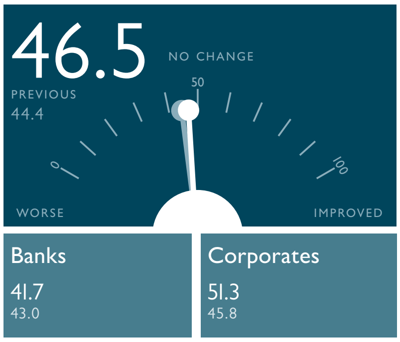
RECORD YEAR FOR BONDS...

A strong fourth quarter brings the volume of outstanding bonds to nearly SEK 51 billion, which is 15.7 per cent of the listed sector's interest-bearing debt.

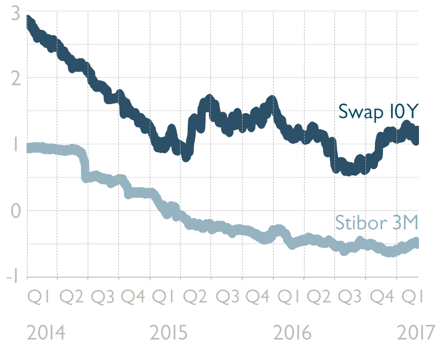
...BUT A SLOW YEAR FOR PREFERENCE SHARES

With only one new issue on OMX Nasdaq Nordic Main Market in the past year, the primary market for property-related preference shares has been slow.

CREDI Main index



Swedish key interest rates, 2014–2016. Per cent



Loan-to-value Q4 average	53.4%	Interest rate Q4 average	2.5%	Fixed credit term Q4 average	3.2 y	Fixed interest term Q4 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. Subscribe to CREDI at catella.se/CREDI

The CREDI Survey

The CREDI Main Index increased from 44.4 to 46.5 in the March survey, driven in particular by a much more positive view of the market among property companies. Although the debt market remains in contraction, the Main index is approaching the 50.0 turning point.

Main index components

Even though the CREDI Main Index remains below the 50.0 turning point, as it has for the past five surveys, the March survey has the strongest Main index figures since September 2015. This improvement is driven by a strong upswing in the Current Situation index, which has increased from 42.6 to 48.3. As such, the Current Situation index is very close to crossing the 50.0 turning point. However, the Main index is held back by a worsened Expectations index, which has fallen from 46.2 to 44.6.

As has been the case throughout the history of CREDI, property companies have exhibited a more positive view of the market than the banks. In the most recent survey, property companies believe that the market conditions have improved during the past three months, as indicated by their Current Situation index of 55.0. On the other hand, they are a bit cautious with regard to the future, with an Expectation index of 47.5.

In comparison, the banks have a much more negative view of the credit market. Their Current Situation index decreased from 42.2 to 41.7, while their Expectations index decreased from 43.8 to 41.7. As such, the surveyed banks believe that the credit market has worsened in the past three months and that it will continue to worsen.

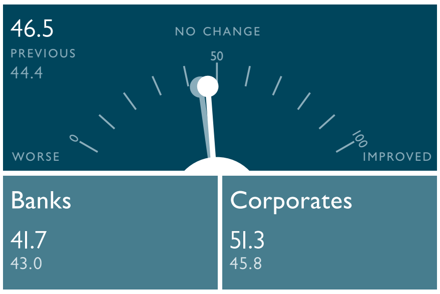
Furthermore, the consensus observed between the parties in the past three surveys is nowhere to be found. In fact, the current spread between property companies and banks is the largest since March 2016.

Sub-indices

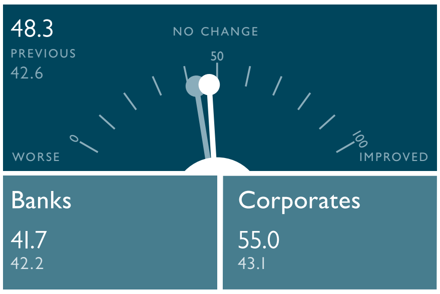
Looking at the underlying sub-indices, we see that two of the sub-indices have a positive impact on the Main index while the other two have a negative impact. The Current Credit Availability sub-index has seen an impressive improvement in the past quarter, going from 37.8 in the December survey to 62.2 in the March survey.

In addition to credit availability, the two Duration sub-indices have had a positive effect on the Main index. On the other hand, the Credit Margins sub-indices remain in the low 30s, while the Leverage sub-indices have worsened noticeably since the December survey. To sum up, increasing credit margins are the main reason why the credit market remains in contraction.

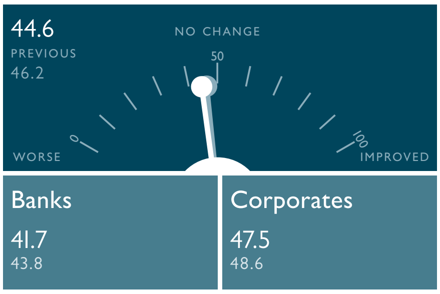
CREDI Main index



Current situation



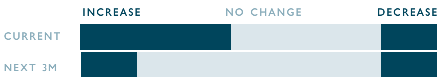
Expectation



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.

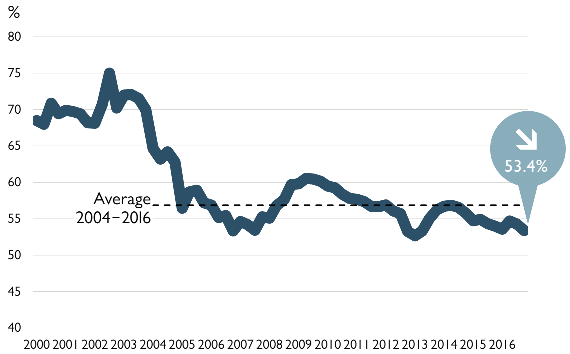
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 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

In the fourth quarter of 2016, the CREDI Indices indicate that the listed property companies have become more careful with regard to their debt financing, with a falling average loan-to-value and increasing fixed credit terms.

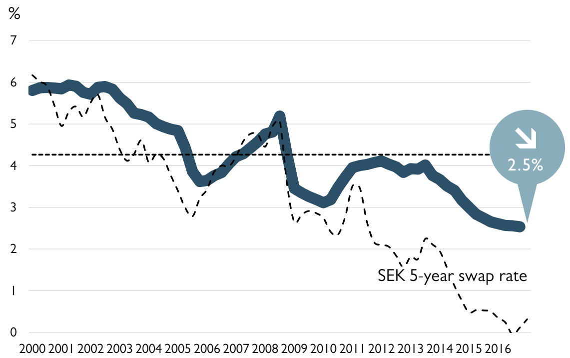
Listed sector Q4 average loan-to-value[1]



In the fourth quarter of 2016, the listed property companies' loan-to-value decreased from 54.3 per cent to 53.4 per cent. Accordingly, the listed sector has fallen further from the historical average of 56.9 per cent. Looking at the underlying components, property value increased by 6 per cent, from SEK 585 billion to SEK 618 billion, while interest-bearing debt increased by 4 per cent, from SEK 309 billion to SEK 322 billion.

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

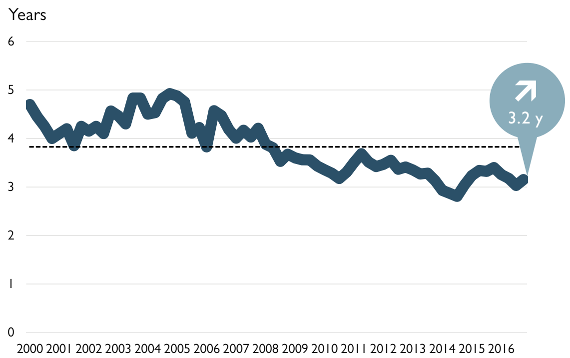
Listed sector Q4 average interest rate[2]



The average interest rate decreased slightly in the fourth quarter of 2016, from 2.56 per cent to 2.54 per cent. This is a continuation of the trend of decreasing interest rates that stretches back to 2013. Nevertheless, the average interest rate is plateauing as one third of the listed companies actually increased their average interest rate. Moreover, the increasing 5-year swap rate suggests that the average interest rate might increase in the coming quarters.

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

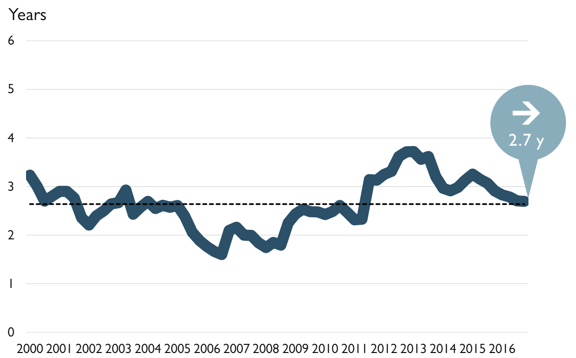
Listed sector Q4 average fixed credit term[3]



Following three consecutive quarters of reduced credit terms, the average fixed credit term among listed property companies increased from 3.0 years to 3.2 years in the fourth quarter of 2016. The return to increasing average fixed credit term could indicate that property companies expect refinancing risk to increase in the near future. Indeed, nearly half of the surveyed companies extended their fixed credit term during the most recent quarter.

3 Average maturity referring to interest-bearing debt.

Listed sector Q4 average fixed interest term[4]



-------- Average 2000–2016

The average fixed interest term among listed property companies has plateaued at approximately 2.7 years, following six consecutive quarter of falling fixed interest terms. Although a majority of the listed companies decreased their interest terms, a number of actors increased their interest terms considerably. The stabilised average fixed interest terms suggest that the property companies do not expect interest rates to decrease further in the near future.

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.

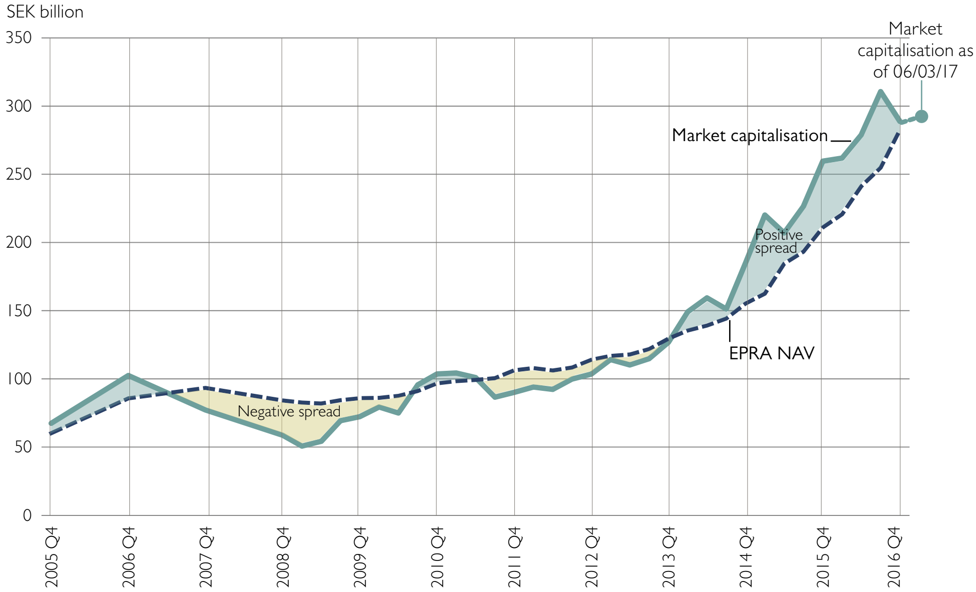
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

CREDI – Common shares

The fourth quarter of 2016 was characterised by a decreasing market capitalisation among property companies listed on Nasdaq OMX Nordic Main Market. This downturn in the stock market resulted in lower market premiums and higher implicit yields.

During the fourth quarter of 2016, property companies on Nasdaq OMX Nordic Main Market took a substantial hit as market capitalisation fell from SEK 311 billion to SEK 289 billion, which corresponds to a drop of 7 per cent. At the same time, the listed companies' EPRA NAV increased from SEK 255 billion to SEK 282 billion, which is an 11 per cent increase. Consequently, market premiums decreased substantially, from SEK 56 billion to SEK 6.3 billion. This constitutes a drop of nearly 90 per cent. However, since the end of the fourth quarter, the stock market has recovered slightly and the listed companies' market capitalisation has increased to SEK 293 billion as of 6 March 2017. As a result, market premiums will probably increase during the first quarter of 2017.

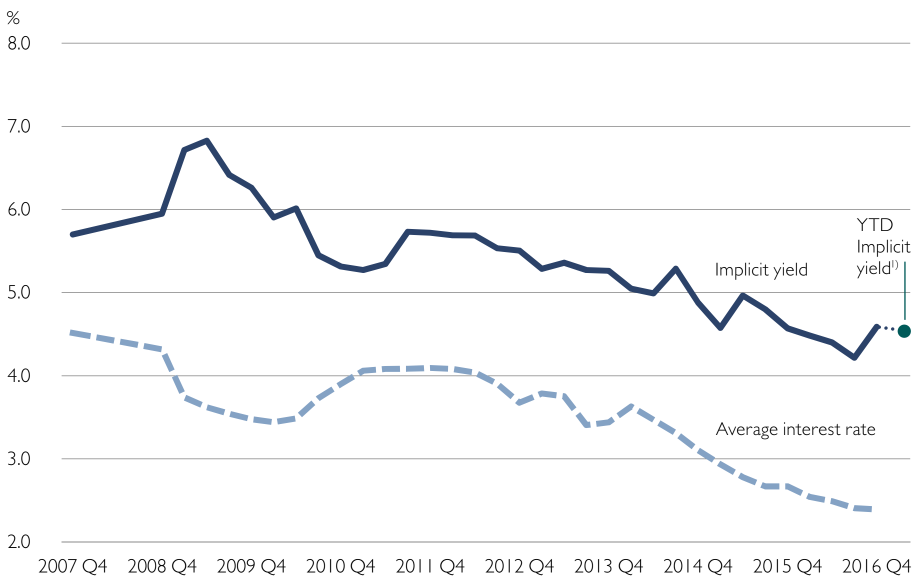
Premium or discount – market capitalisation as share of EPRA NAV



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.

The implicit yield of listed property companies has increased from 4.22 per cent in the third quarter of 2016 to 4.59 per cent in the fourth quarter of 2016, marking an end to the year-long trend of falling implicit yields. This means that the stock market has valued the property companies' net operating income slightly lower in the fourth quarter of 2016 than it did in the four previous quarters, as suggested in the December issue of CREDI. However, the current year-to-date implicit yield suggests that property companies' average implicit yield will be slightly lower in the first quarter of 2017, as the stock market recovers somewhat. Looking at different sub-sectors, the implicit yield is below average among property companies with commercial property in central Stockholm and Gothenburg and among residential property companies, while it is substantially higher among geographically diversified companies and those specialising in industrial property.

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



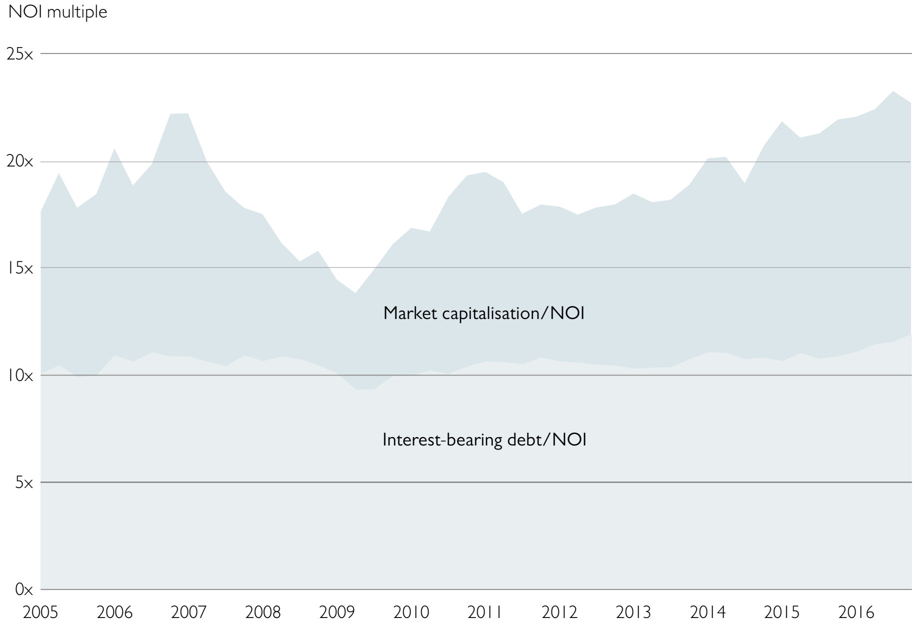
[1] Market values 06/03/2017 and Q4 2016 EPRA NAV.

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.

Looking at how property companies' interest-bearing debt and market capitalisation have developed in relation to their NOI since 2005, it is possible to see that the stock market and banks reacted differently to the financial crisis. In 2007, the stock market valued property companies at 11.4 times their NOI, while interest-bearing debt was approximately 10.9 times NOI. However, while market capitalisation fell to 4.5 times NOI, the debt never fell below a multiple of 9.3. This means that the stock market has been significantly more volatile while banks have increased 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 NOI). In the fourth quarter of 2016, interest-bearing debt in relation to NOI increased slightly while market capitalisation decreased by approximately one year's NOI.

Interest-bearing debt and market capitalisation in relation to NOI



Note. Property companies on Nasdaq OMX Nordic Main Market.

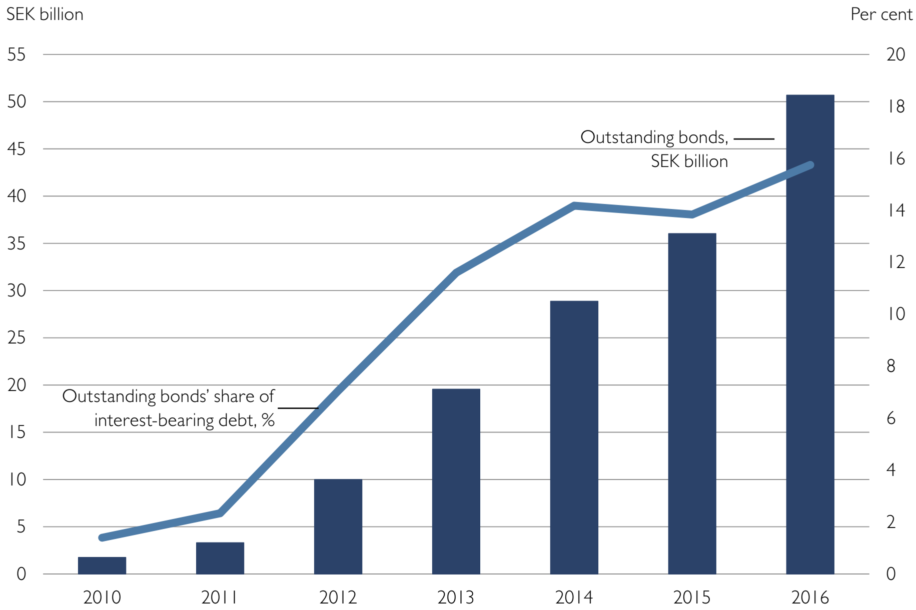
CREDI – Bonds

A particularly strong fourth quarter made 2016 a record year for corporate bonds among listed property companies on Nasdaq OMX Nordic Main Market.

During 2016, listed property companies increased their volume of corporate bonds from SEK 36 billion to nearly SEK 51 billion. This is an annual increase of nearly SEK 15 billion. In 2015, the volume of outstanding corporate bonds increased by SEK 7 billion. In terms of the proportional increase, outstanding corporate bonds increased by 41 per cent, which is lower than in 2014 (48 per cent) and 2013 (96 per cent), but exceeds the increase in 2015 (25 per cent). However, what makes 2016 a record year is that corporate bonds' share of interest-bearing debt exceeded 15 per cent for the first time in history.

In fact, at the end of 2016, 15.7 per cent of listed property companies' interest-bearing debt was made up of corporate bonds. This increase was brought about thanks to particularly large issues by Castellum.

Outstanding bonds

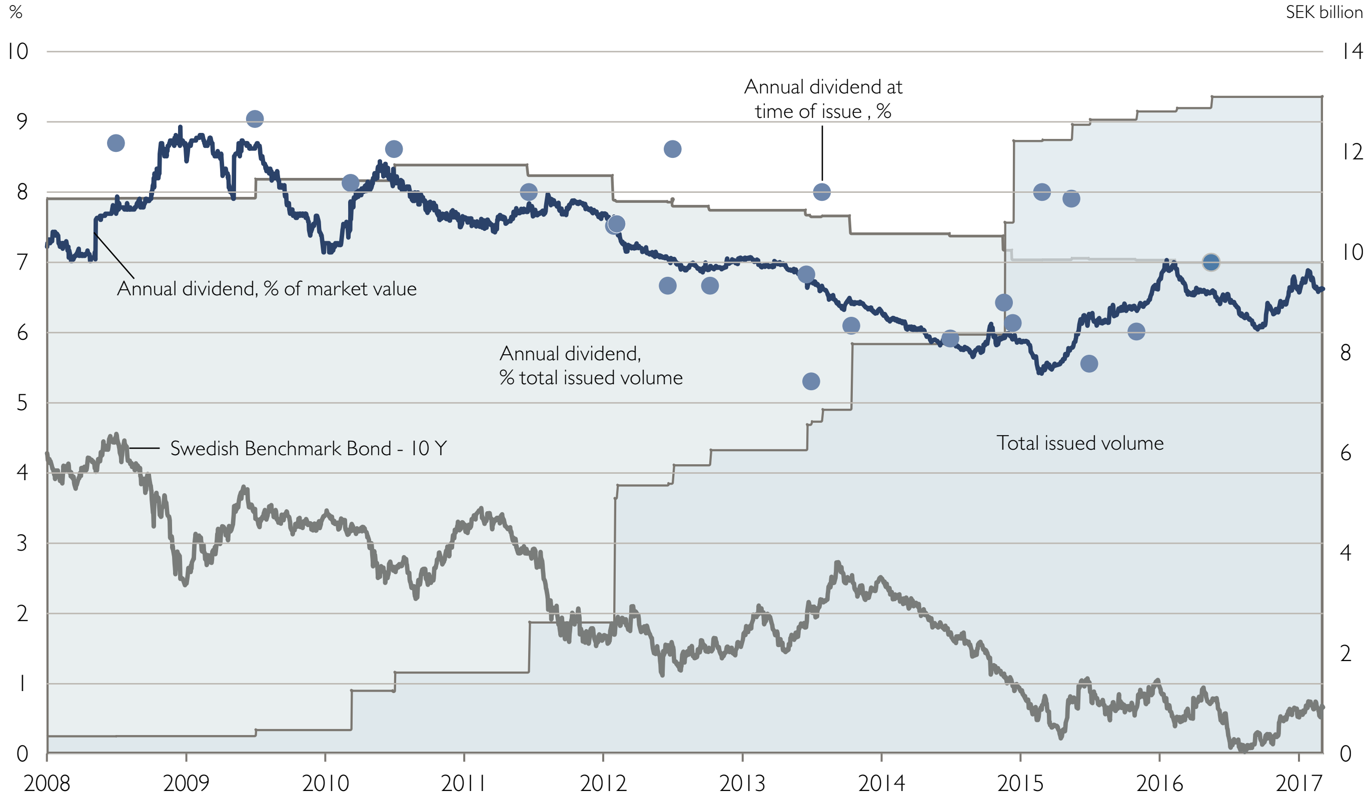


Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Preference shares

The fourth quarter marked the end of an uneventful year for property-related preference shares on Nasdaq OMX Nordic Main Market, with only a single issue for the entire year. On the other hand, the average dividend to market prices has been rather volatile throughout the year, and has remained so in the first months of 2017.

Property companies' preference shares on Nasdaq OMX Nordic Main Market



The frequency of new issues of property-related preference shares has dropped significantly in the past year, with only a single issue on Nasdaq OMX Nordic Main Market throughout 2016 and none so far in 2017. Accordingly, the total issued volume has remained at SEK 13.1 billion since May 2016, for which property companies pay an average dividend of 7.01 per cent.

However, although the primary market has been constant for nearly a year, the secondary market has been fairly eventful. In addition, due to the lack of issues on the primary market, it is possible to study how the average dividend of the issued preference shares in relation to market prices has developed over time on the secondary market.

In early 2016, the average dividend peaked at 7 per cent, after a year-long trend of falling preference share prices since early 2015. Following the peak, the average dividend would fall to 6.04 per cent in mid-September, only to bounce back to 6.65 per cent at the end of the year. Since then, the average dividend continued to rise throughout January, but has since fallen to 6.62 per cent as of 6 March 2017.

The fluctuations of the dividends are linked to long-term interest rates. For the past six months in particular, the fluctuations of the average dividend on the secondary market are more or less mirrored by the development of the 10-year Swedish Benchmark Bond, which is currently hovering around 0.67 per cent.

Although there has been a lack of issues of property-related preference shares in the recent year, this is not necessarily an indication of a lack of interest in preference shares as a source of capital. The property companies' net operating income have not increased considerably since the majority of the issues were made, meaning that we could be experiencing a natural intermission that will remain until the proportion of preference shares to common shares falls below a certain threshold.

CREDI – Catella's view through the looking glass

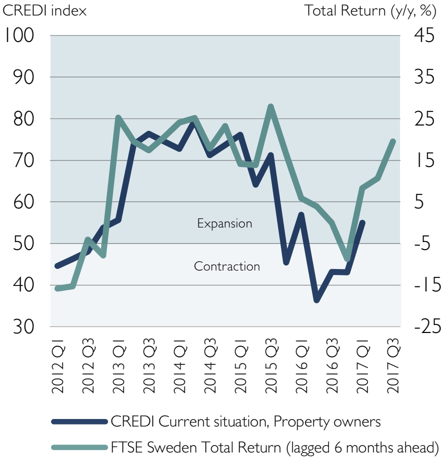
A changing macro environment creates opportunities outside the major cities.

There has been a clear upswing in market sentiments among property companies during the first quarter of 2017. The Swedish equity market has been a leading indicator of the CREDI Current Situation index over time and the recent strong equity market performance points towards a continuous improvement during the rest of 2017.

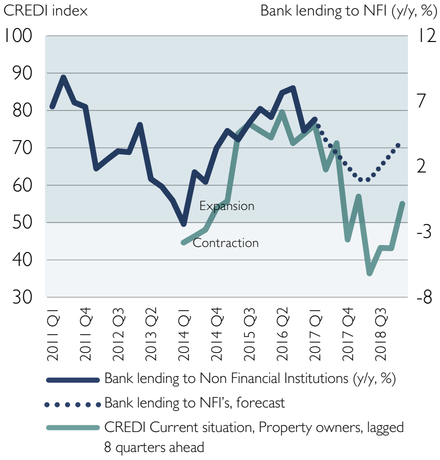
GDP growth in both the Euro area and the US are picking up and there seems to be an ongoing shift from monetary policy to more active fiscal policy, leading to continuously increasing long-term interest rates. With regard to Sweden, we are currently at full capacity utilisation. This means that the 10-year-period of strong, domestically driven GDP growth combined with an imported low inflation and low long-term interest rates is about to end. From now on, economic growth will slow down towards the potential growth rate (around 1.5–2.0 per cent annually), which will be combined with somewhat higher inflation and long-term interest rates. These are all factors that contribute to increasing average yields for commercial properties. The most probable explanation to the last six months' average yield increases is that buyers and sellers are now meeting up in secondary locations, where yields are generally higher.

Since the early 2000s, half of Sweden's GDP growth has been generated in the Stockholm region, while around 25 per cent has been generated in the Gothenburg and Malmö regions. This apparent geographic concentration of growth has not gone unnoticed by property investors. For commercial properties, basically all the major investors are focusing on good locations in large cities. Simultaneously the listed property companies are streamlining their portfolios by selling (or at least attempting to sell) properties in secondary locations and in smaller cities. Taken as a whole, the majority of large property investors focus on the same office and retail locations in the large cities, resulting in a large number of bidders for properties in those locations, while there are many sellers but few investors in locations with lower priority. Even though there is no rental growth over time in these locations, there are now good opportunities for investors with good market knowledge and efficient management models to invest in these locations without encountering a lot of competition.

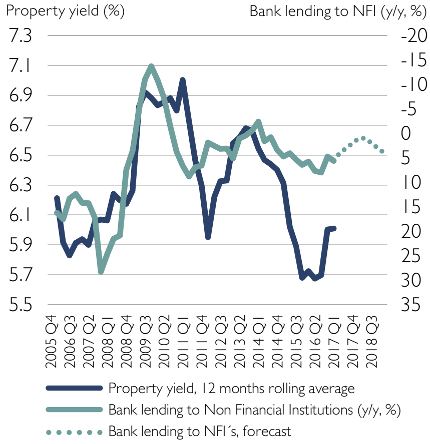
CREDI Current Situation for property owners and FTSE Sweden



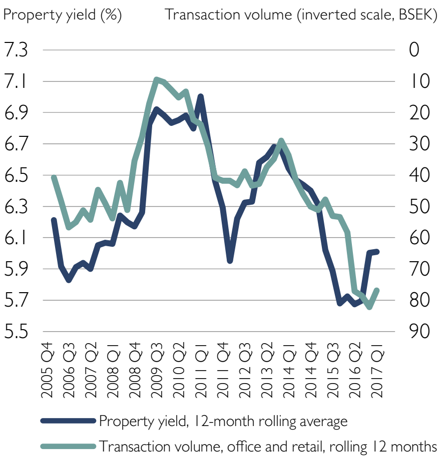
CREDI Current Situation for property owners and Bank lending to Non Financial Institutions



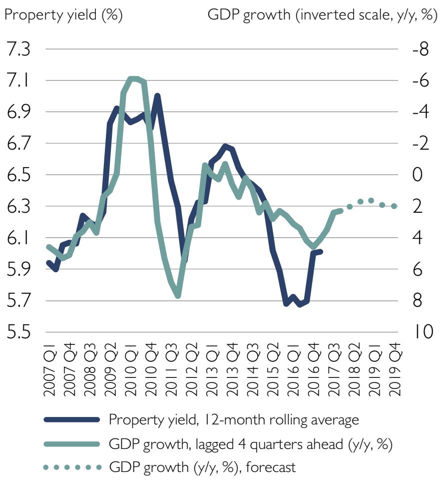
Average property yield* and Bank lending to Non Financial Institutions



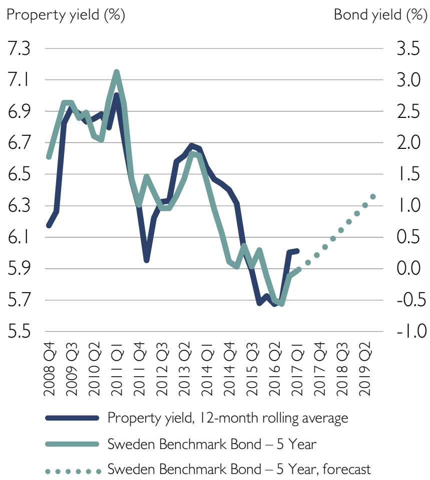
Average property yield* and transaction volume



Average property yield* and GDP growth



Average property yield* and Benchmark Bond



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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