CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

CREDI June 2017

Weaker market sentiment as credit margins increase

In this June issue of CREDI, the Main index has fallen noticeably. This is driven by a weakened market sentiment among property companies and increasing credit margins. At the same time, the first quarter of 2017 had the largest ever increase in corporate bonds, which currently make up 21 per cent of the property sector's debt.

THE CREDI MAIN INDEX FELL IN THE PAST THREE MONTHS

The property debt financing market remains in contraction, as the CREDI Main index falls from 46.5 to 41.8. This is the largest drop since the autumn of 2015, and is caused by a particularly low Current Situation index.

THE CURRENT SITUATION INDEX IS AT A HISTORIC LOW

In the June survey, the Current Situation index was merely 38.8. This is the second lowest value in the history of CREDI, and is the result of a deteriorating market sentiment among banks and property companies alike.

MARKET AGREES THAT CREDIT MARGINS ARE INCREASING

Banks and property companies agree that credit margins have increased in the past three months, and believe that they will increase further in the future. Nearly 90 per cent of the surveyed banks reported higher credit margins.

PROPERTY SHARES TRADED AT A DISCOUNT AT THE END OF Q1...

During the first quarter of 2017, the market capitalisation of listed property companies fell while asset values increased. Consequently, at the end of the quarter, property shares traded at a discount for the first time since 2013.

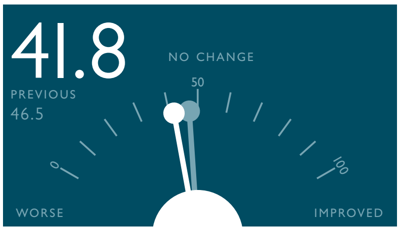
...BUT THE STOCK MARKET HAS RECOVERED CONSIDERABLY

Since the end of the first quarter, market capitalisation of property companies on Nasdaq OMX Nordic Main Market has increased significantly. This suggests that property shares will trade at a premium at the end of the second quarter.

RECORD QUARTER FOR BONDS

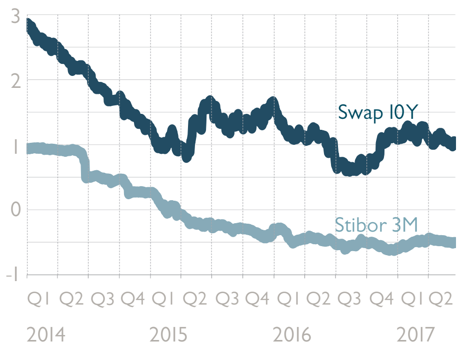
The volume of outstanding corporate bonds in the listed property sector increased by 33 per cent to SEK 67.3 billion during the first quarter. This means that bonds make up 21 per cent of property companies' interest-bearing debt, which is its highest share ever.

CREDI Main index



Banks	Corporates
37.5	46.1
41.7	51.3

Swedish key interest rates, 2014–2017. Per cent



Loan-to-value Q1 average	Interest rate Q1 average	Fixed credit term Q1 average	Fixed interest term Q1 average
↘ 52.6%	↘ 2.5%	→ 3.2 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

The CREDI Main index fell from 46.5 to 41.8 in the June survey of CREDI, marking the end of a one-year-long climb. The drop is the biggest since the autumn of 2015, and is driven by a particularly low Current Situation index of 38.8, which is the second lowest in the history of CREDI.

Main index components

Over the past twelve months, the CREDI Main index has steadily improved with each new survey, going from 41.0 in June 2016 to 46.5 in March 2017. This trend of a rising Main index came to a halt with the June survey, as the Main index fell by 4.7 index points to 41.8, marking the biggest drop in the Main index since the autumn of 2015.

This new development is driven almost entirely by fluctuations in the Current Situation index. While the Expectation index improved slightly from 44.6 to 44.8, the Current Situation index fell 9.5 index points from 48.3 to 38.8. This is the second lowest value for the Current Situation index in the history of CREDI, the lowest being 35.4 in June 2016.

As has been the case throughout the history of CREDI, property companies have exhibited a more positive view of the credit market than the banks, as the banks cater to a wider range of clients. Although property companies and banks reached something of a consensus in 2016, their responses in the March 2017 survey diverged considerably, differing nearly 10 index points. This spread between the Main index values of property companies and banks has remained in the June 2017 survey.

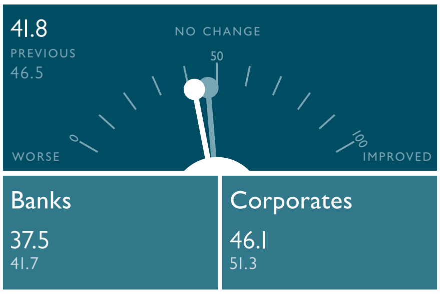
On a positive note, the Expectation index improved slightly to 44.8, up from 44.6 in March. In addition, the Expectation index for property companies reached 50.8, crossing the 50.0 turning point for the first time since June 2016.

Sub-indices

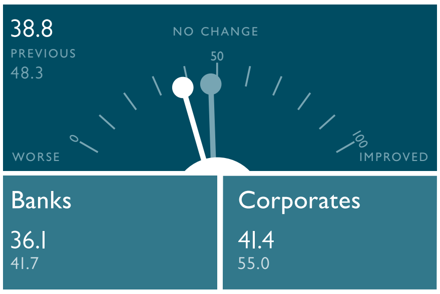
Looking at the results from the June survey, we see that the Credit Margins sub-indices had the most significant impact on the Main index. Nearly 90 per cent of the surveyed banks believe that credit margins have increased in the past three months, as do nearly half of the surveyed property companies. Taken together, this gives us a Current Credit Margins sub-index of 18.4. Respondents are slightly less bearish with regard to expectations for future credit margins, bringing the Expectation Credit Margin sub-index up to 33.0.

With regard to the other sub-indices, credit availability and duration have remained unchanged while the Leverage sub-indices were slightly weakened.

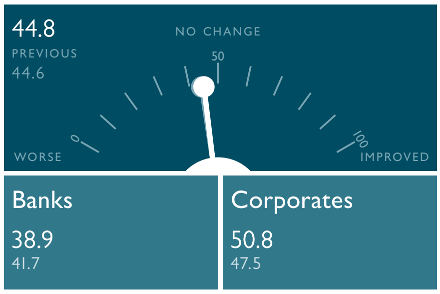
CREDI Main index



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.

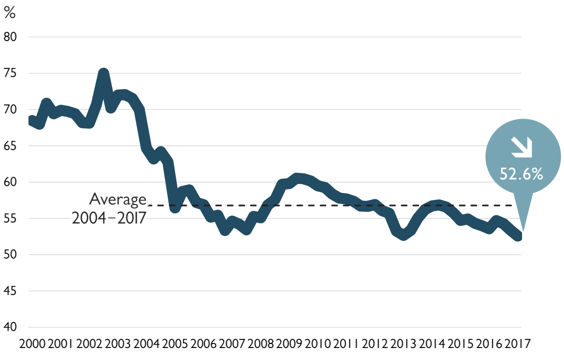
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. As such, the final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals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

In the first quarter of 2017, the CREDI Indices suggest that the listed property companies have become more careful with regard to their debt financing, as the average loan-to-value has fallen and fixed interest terms have increased.

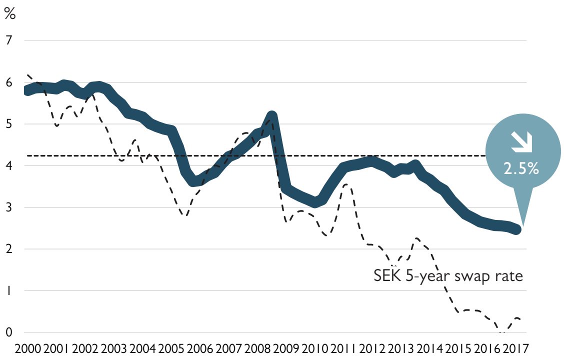
Listed sector QI average loan-to-value[1]



The listed property companies' loan-to-value decreased in the first quarter of 2017, from 53.4 per cent to 52.6 per cent. As such, the average loan-to-value of the listed sector is noticeably below the historical average of 56.8 per cent. With regard to the underlying components, property values increased by 4 per cent, from SEK 618 billion to SEK 641 billion, while interest-bearing debt increased by 2 per cent, from SEK 322 billion to SEK 327 billion. As such, the decrease in loan-to-value is driven by increased property values rather than decreased debt.

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

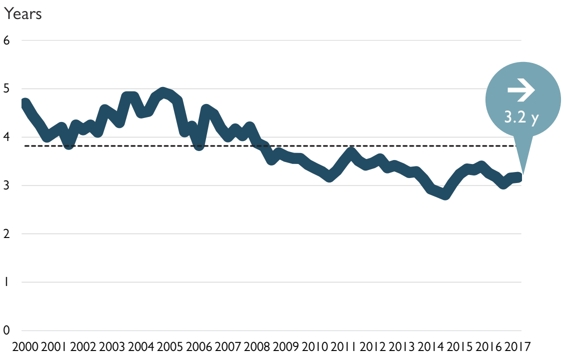
Listed sector QI average interest rate[2]



In the first quarter of 2017, the average interest rate decreased from 2.54 per cent to 2.47 per cent. This is a continuation of the trend of decreasing interest rates that stretches back to the third quarter of 2013. Approximately one third of the listed property companies reduced their interest rate during the quarter, while the interest rate of half the companies remained unchanged during the same period.

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

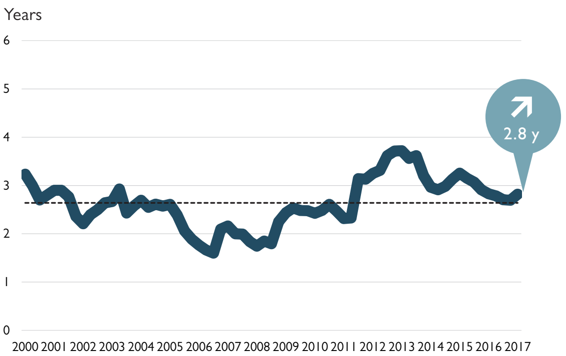
Listed sector QI average fixed credit term[3]



The average fixed credit term among listed property companies remained at 3.2 years in the first quarter of 2017, marking the smallest change in the index since 2009. Approximately one third of the surveyed companies extended their fixed credit term during the quarter, while half of the surveyed companies reduced their fixed credit term.

3 Average maturity referring to interest-bearing debt.

Listed sector QI average fixed interest term[4]



-------- Average 2000–2017

Following seven consecutive quarters of falling fixed interest terms, the average fixed interest term among listed property companies increased from 2.7 to 2.8 years in the first quarter. The increasing average fixed interest term suggests that property companies do not expect interest rates to decrease further in the near future. This development during the quarter means that the average fixed interest term moves further away from 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.

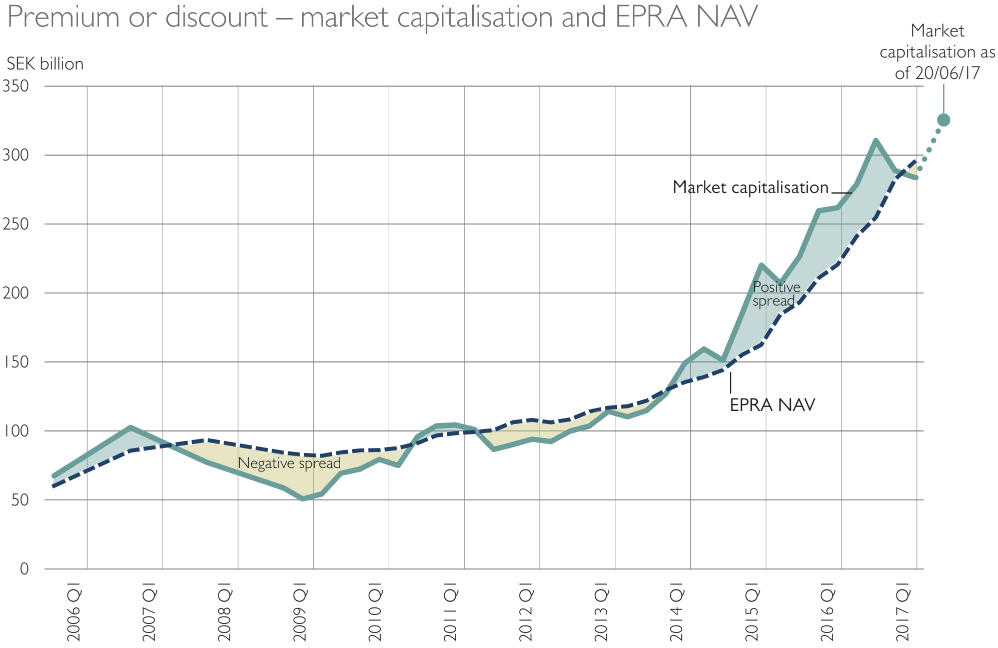
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

CREDI – Common shares

At the end of the first quarter of 2017, listed property companies had continued to drop in their market capitalisation and property shares traded at a discount for the first time since 2013. However, since then the stock market has recovered considerably, indicating a stronger equity market for the second quarter.

Following a substantial drop in the fourth quarter of 2016, the market capitalisation of property companies on Nasdaq OMX Nordic Main Market continued to fall during the first quarter of 2017, dropping to SEK 284 billion. At the same time, the listed companies' EPRA NAV increased to SEK 295 billion. Consequently, the listed property companies traded at a discount at the end of the quarter, marking the end of a three-year long market premium. At the end of the first quarter, the listed sector traded at SEK 11.1 billion below the sectors' EPRA NAV, corresponding to a discount of 3.8 per cent. However, since then, the stock market has recovered noticeably and the listed companies' market capitalisation has increased by more than 13 per cent as of 20 June 2017. As a result, the stock market is likely to trade at a premium at the end of the second quarter.

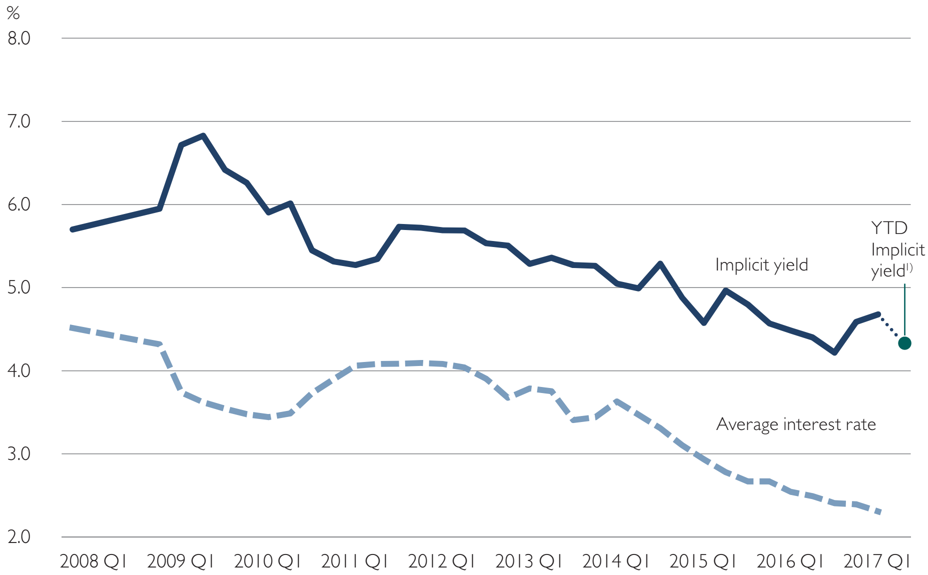
Premium or discount – market capitalisation and EPRA NAV



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 property companies on Nasdaq OMX Nordic Main Market has increased slightly from 4.6 per cent in the fourth quarter of 2016 to 4.7 per cent in the first quarter of 2017. The rising implicit yield is the result of the stock market valuing the property companies' net operating income lower than in the previous quarter, as the net operating income of the listed sector increased during the quarter. Nevertheless, the year-to-date implicit yield indicates a lower average implicit yield for the second quarter of 2017, due to a reinvigorated stock market that has recovered the losses from the two preceding quarters as of 20 June 2017.

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



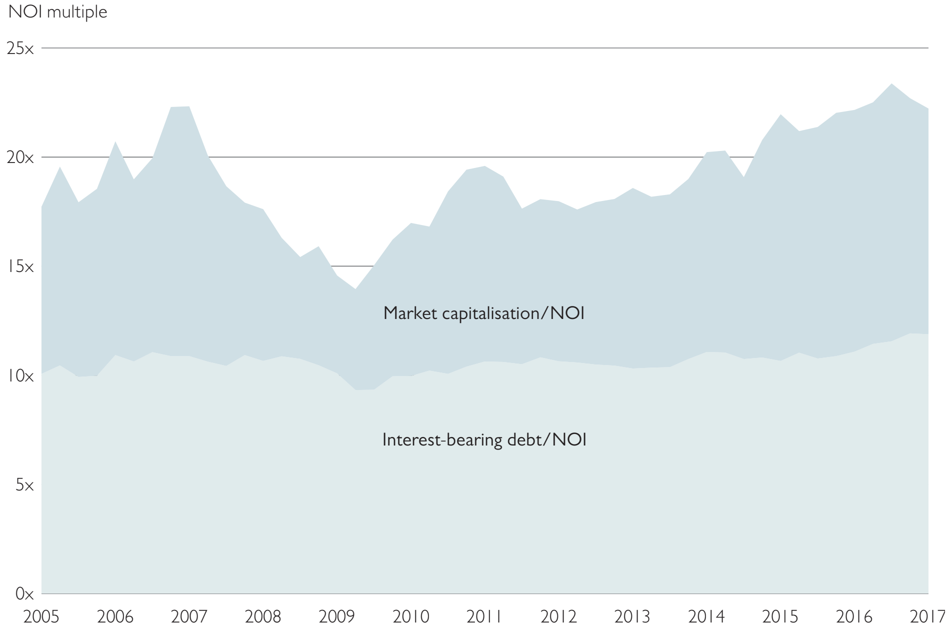
[1] Market values 20/06/2017 and Q1 2017 EPRA NAV.

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.

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 would fall to 4.5 times net operating income, while the debt never fell below a multiple of 9.3. This means that 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 net operating income. In the first quarter of 2017, interest-bearing debt has remained at 11.9 times net operating income, while market capitalisation decreased from 10.8 to 10.3 times net operating income.

Interest-bearing debt and market capitalisation in relation to NOI



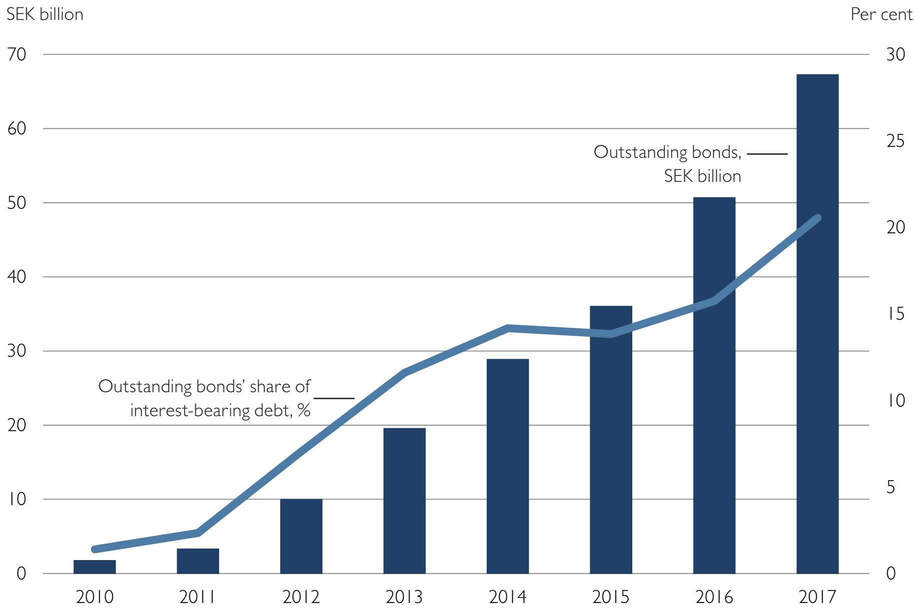
Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Bonds

Following a strong fourth quarter in 2016, the first quarter of 2017 saw the largest ever increase in volume for corporate bonds among listed property companies.

Bonds are becoming increasingly more popular among property companies on Nasdaq OMX Nordic Main Market. Having amounted to less than SEK 2 billion at the end of 2010, the total volume of outstanding corporate bonds reached SEK 67 billion at the end of the first quarter of 2017. Since the turn of the year, the outstanding volume has increased by nearly SEK 17 billion, or 33 per cent, making it the largest proportional quarterly increase in more than four years and the largest ever nominal quarterly increase. At the end of the first quarter of 2017, as much as 20.6 per cent of listed property companies' interest-bearing debt was made up of corporate bonds. This increase was to a great extent a result of Balder issuing EUR 1 billion in the European bond market during the quarter, accounting for more than half of the increase in volume.

Outstanding bonds

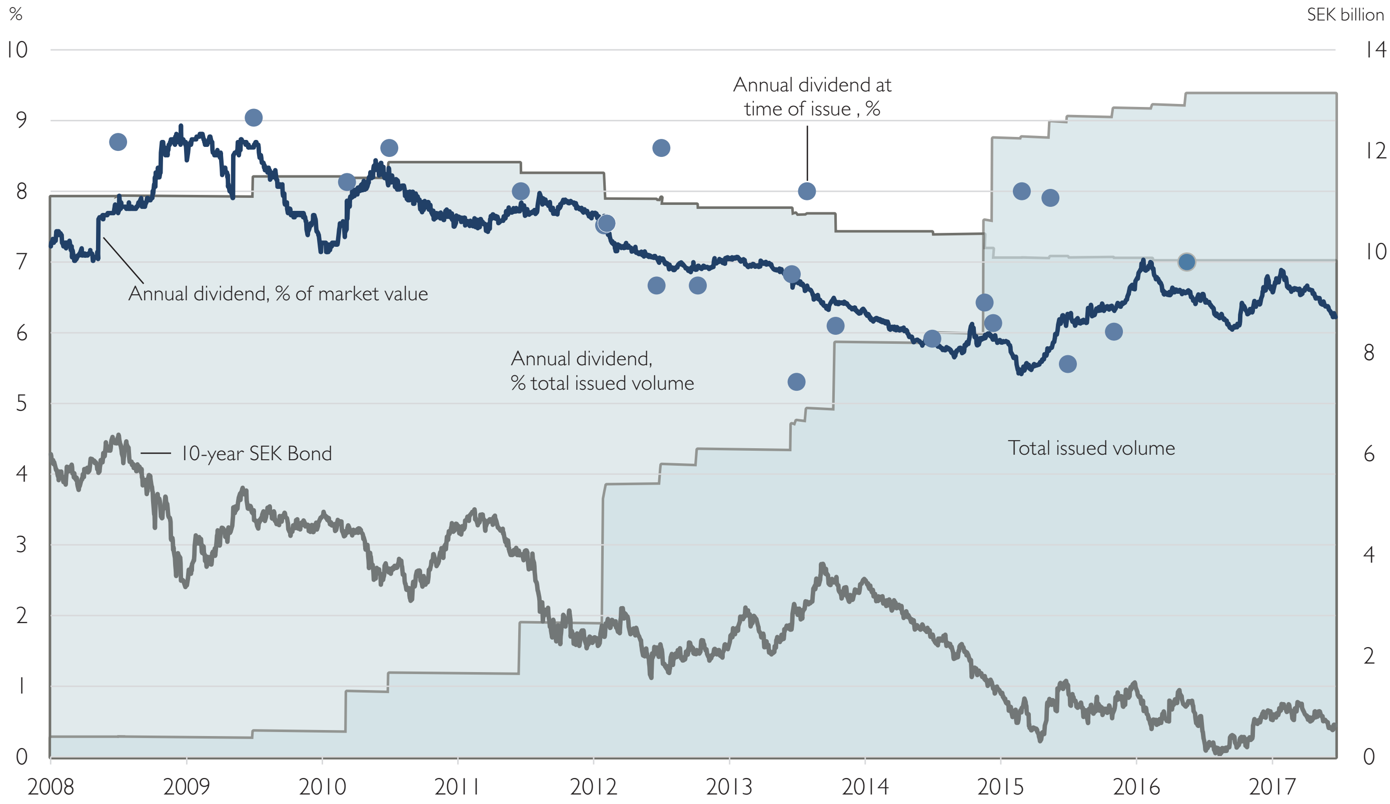


Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Preference shares

Throughout the first half of 2017, the average dividend of property-related preference shares on Nasdaq OMX Nordic Main Market has fallen, mirroring a fall in the 10-year SEK Bond. The market for preference shares has been fairly uneventful, with not a single issue in more than a year.

Property companies' preference shares on Nasdaq OMX Nordic Main Market



In an uneventful year for preference shares, there has not been a single new issue in the past twelve months on Nasdaq OMX Nordic Main Market. The total issued volume has remained at SEK 13.1 billion since May 2016, for which property companies pay an average dividend of 7.0 per cent on the issued volume

Nevertheless, although the primary market has been constant for more than a year, the secondary market has fluctuated noticeable. In early 2016, the average dividend peaked at 7.0 per cent, after a year-long trend of falling preference share prices since early 2015. Following the peak in early 2016, the average dividend would drop to 6.0 per cent in mid-September, only to bounce back to 6.7 per cent at the end of the year. During 2017, the average dividend peaked at 6.9 per cent at the end of January, but has since fallen. As of 20 June, the average dividend is 6.2 per cent.

The fluctuations of the average yields are strongly linked to long-term interest rates. For the past twelve 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 SEK Bond, which is currently hovering around 0.4 per cent.

Although there has been a lack of issues of property-related preference shares in the past year, this is not necessarily an indication of a lack of interest in preference shares as a source of capital. Property companies' net operating income has 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.

On the other hand, the bond market has risen as an attractive source of capital, which might have impacted the frequency of new issues of preference shares.

CREDI – Catella's view through the looking glass

The Current Situation index indicates higher average yields, but opportunities are arising in smaller cities.

The market sentiment among property companies worsened significantly in the June survey of CREDI. The Swedish equity market has been a strong leading indicator of the CREDI Current Situation index for property owners over time. The past six months' strong development on the equity market points to a stabilisation of the Current Situation index for property owners at around the 50-mark in the coming quarters (which indicates a neutral market sentiment). The CREDI Current Situation index for property owners is a good leading indicator of Swedish banks' lending to property companies, which in turn is a very strong leading indicator of the transaction volume for office and retail properties (the correlation coefficient for quarterly data over ten years is 0.78, where bank lending is two quarters ahead of the transactions volumes).

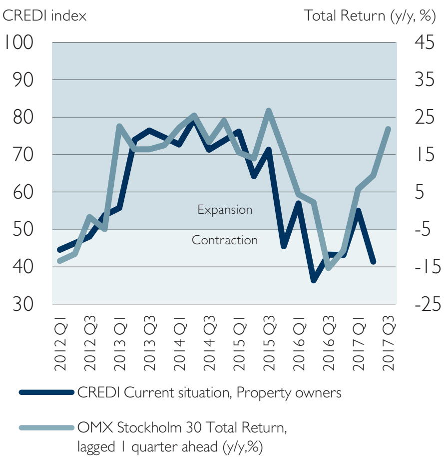
The listed property companies are currently selling commercial properties in non-priority locations as well as making selective investments in good locations in the major cities and investments in their current portfolios. Taken as a whole, the majority of large property investors – both private and institutional – focus on the same office and retail locations in the large cities, while there are many sellers but few investors in locations with lower priority.

The main reason for the past twelve months' increase in average yields is higher average yields for retail properties. Buyers and sellers have moved towards transactions involving shopping centres and Big-Box properties outside the main cities during the past 12–18 months, where yields are generally higher.

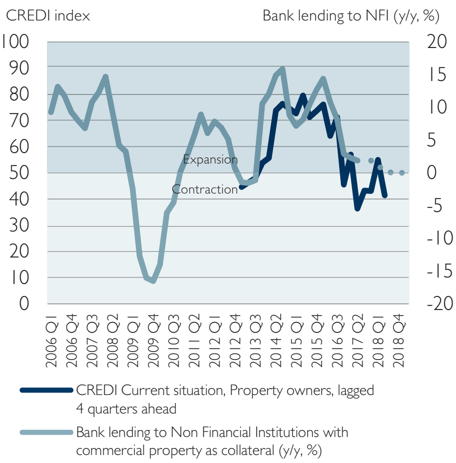
Investor demand for prime office and retail properties in the major cities is expected to remain strong, although yield spreads between A, B and C locations in the major cities will likely increase. However, there are good opportunities for investors with good market-knowledge, access to financing and efficient management models to invest in locations outside the major cities without encountering a lot of competition.

The recent CREDI development indicates a slowdown in the banks' lending and a stabilisation in transaction volumes in the coming 9–12 months, as well as an additional 30–50 basis point increase in the average yield for office and retail properties.

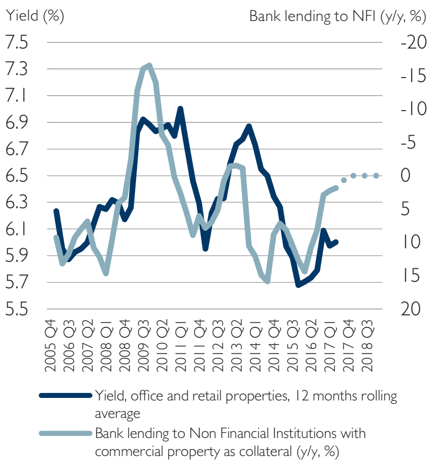
CREDI Current Situation index for property owners and OMX Stockholm 30



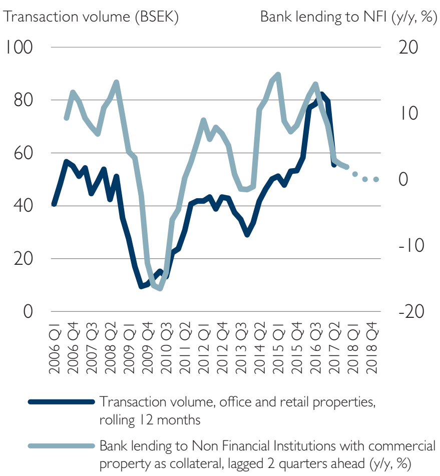
CREDI Current Situation and bank lending with commercial property as collateral



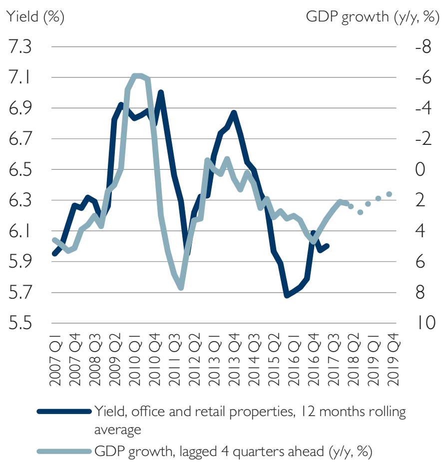
Average property yields* and bank lending with commercial property as collateral



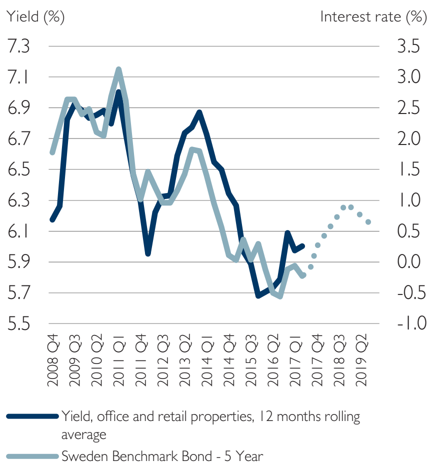
Transaction volume and bank lending with commercial property as collateral



Average property yields* and GDP growth



Average property yields* and Swedish Benchmark Bond yields



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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