CATELLA

CREDI
CATELLA REAL ESTATE DEBT INDICATOR

CREDI June 2016

Reaching consensus

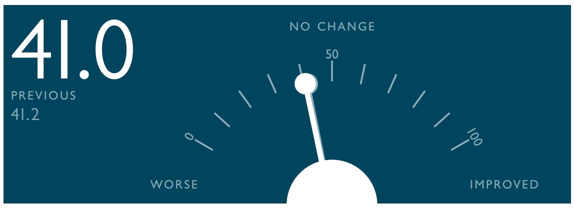
In the June issue of the CREDI survey the Main index fell 0.2 points, from 41.2 to 41.0. In contrast to the Main index' relatively small change, however, the Current Situation index fell to an all-time low of 35.4 while the Expectation index increased from 41.4 to 46.7. Accordingly, both the Main index and its two underlying indices are still below the 50.0 turning point, and the property debt financing market is still very much in contraction.

What is particularly noteworthy about the June issue of the CREDI survey is that banks and corporates are in agreement about the financing climate in the property sector to a much larger extent than in the March survey. Having differed by a whopping 27.4 index points in the previous survey, the spread between polled lenders and borrowers dwindled to just 5.5 index points in the June survey – the smallest difference between banks and corporates since March 2014. Unfortunately, the consensus is that access to financing in the property sector has worsened in the past three months.

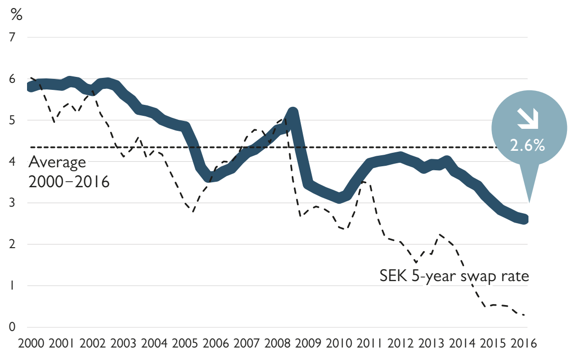
This rather negative view on the financing climate is reflected in other European economies as well, not least in the United Kingdom, which had its weakest GDP growth in a first quarter since 2012. The reason for this turmoil is the United Kingdom's referendum on 23 June 2016 on whether the country should remain in the European Union.

Although the banks and property companies were negative on the current financing climate, they are more optimistic about the coming three months. In fact, the Expectation index for the property sector was 51.1, meaning that property companies believe that access to financing will become slightly better in the next three months. This is reflected in the CREDI indices for the first quarter of 2016. These indices, which are based on listed property companies' reported data from the first quarter of 2016, show a continuation of the trend of falling interest rates and fixed interest terms. Indeed, the average interest rate fell from 2.7 per cent to 2.6 per cent and the average interest term fell from 3.0 years to 2.8 years.

CREDI Main index

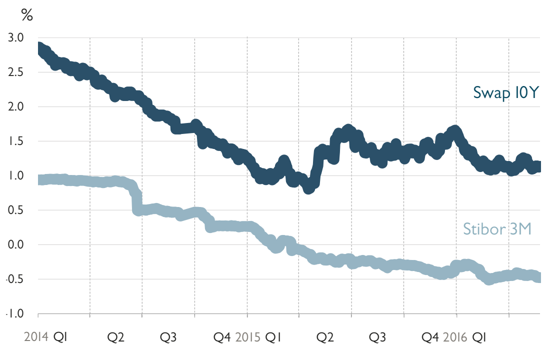


CREDI Indices – Q1 Average interest rate*



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

Swedish key interest rates, 2014–2016



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 Main index has dropped 0.2 points to 41.0 in this June survey, which indicates slightly worsened, albeit stable, access to financing. However, the underlying indices hold a lot of additional information about the past three months. Most importantly, the Current Situation index fell from 41.0 to 35.4 while the Expectation index rose from 41.4 to 46.7, approaching the 50.0 turning point. An interesting observation from the June survey is that polled lenders and borrowers are much more in line with one another, compared with the March survey.

Main index components

Although the Main index has only seen a minor decrease from 41.2 to 41.0, the Current Situation and Expectation indices have exhibited noticeable differences since the March survey. What stands out the most is that the market believes that the financing climate has deteriorated noticeably in the last three months, as the Current Situation index fell to 35.4, its lowest point since the CREDI surveys began in May 2012. One of the reasons for this historically low figure is that the overwhelming majority of both banks and corporates believe that credit margins have increased over the past three months.

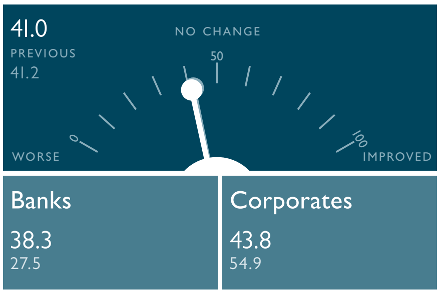
When it comes to the market's expectations for the financing climate in the coming three months, however, things are looking up. Indeed, the Expectation index increased from 41.4 to 46.7, its highest point since September 2015. The market believes that access to financing will only be slightly worse in the coming three months. In particular, the market's expectation regarding credit availability and duration in the next three months has contributed to the positive development of the Expectation index.

Unlike the March survey, where banks and corporates displayed vastly differing views of the market, with an unprecedented spread of 27.4 index points, in the June survey, the parties appear to have reached something of a consensus. As banks have become more positive and corporates have become more negative, the parties had very similar views on the current situation.

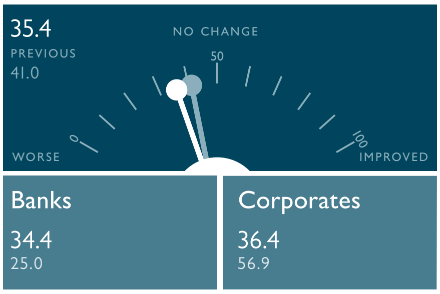
Sub-indices

The sub-indices of the CREDI survey exhibited similar behaviour to the Main index, in that most of the Current sub-indices decreased while the Expectation sub-indices tended to increase. The Current Leverage sub-index saw the largest decrease at 17.3 index points, while the Expectation Duration and the Expectation Credit Availability sub-indices increased, crossing the 50.0 turning point. The Current Situation sub-indices, on the other hand, were all below the 50.0 turning point. The Current Credit Margin sub-index was particularly low, as it fell 10 index points to 13.0. However, the Current Credit Availability and Current Leverage sub-indices increased by 13.5 and 8.4 index points, respectively.

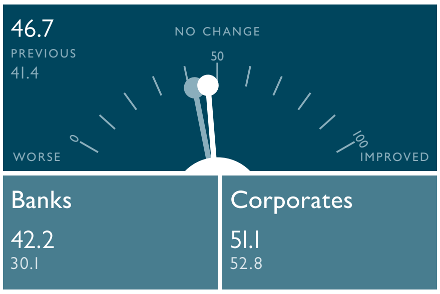
CREDI Main index



Current situation



Expectation



CREDI sub-indices

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.

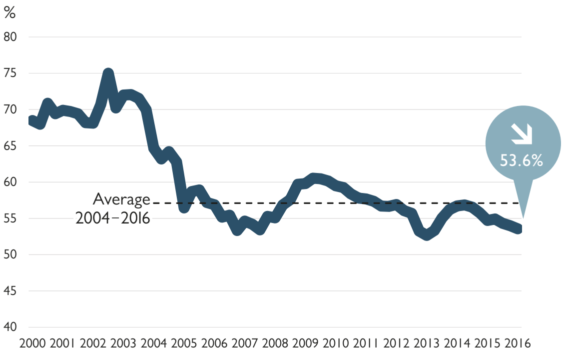
The CREDI survey results are computed as separate diffusion indices per question, where answers are weighted according to their direction of change in the variable. The final index figure represents an average of all weighted answers. Weights are applied such that a "no change"-answer equals 50. Consequently, 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 CREDI Indices for the reported data from the first quarter of 2016 show a continuation of the trend of falling average interest rates and average fixed interest terms. Furthermore, after a brief reversal of the trend of decreasing leverage within the listed sector, average loan-to-value is once again decreasing.

Listed sector Q1 average loan-to-value[1]

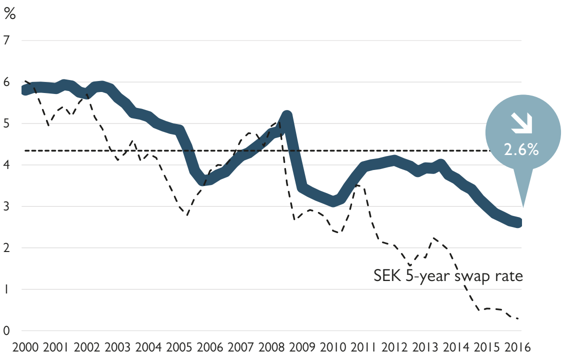


Although the surveyed companies' loan-to-value increased at the end of 2015, their loan-to-value decreased once again in Q1 2016. Leverage fell from 54.9 per cent to 53.6 per cent, prolonging the trend of decreasing leverage that has been observed since Q2 2014. Loan-to-value has been decreasing due to conservative lending by the banks, and increasing property value, among other things.

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

Please note that Castellum's acquisition of Norrporten is not included in the company's Q1 report, and has not had any direct effect on the first quarter's average loan-to-value.

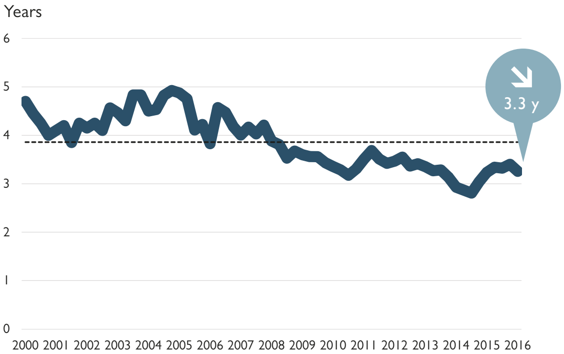
Listed sector Q1 average interest rate[2]



The trend of falling interest rates has persisted as the average interest rate among the surveyed companies decreased from 2.7 per cent in Q4 2015 to 2.6 per cent in Q1 2016. Accordingly, the average interest rate has fallen by 35 per cent since Q2 2012, from 4.0 per cent to 2.6 per cent. This trend is in many ways a consequence of the falling underlying interest rates, as these are very much correlated with the listed sector's interest rates.

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

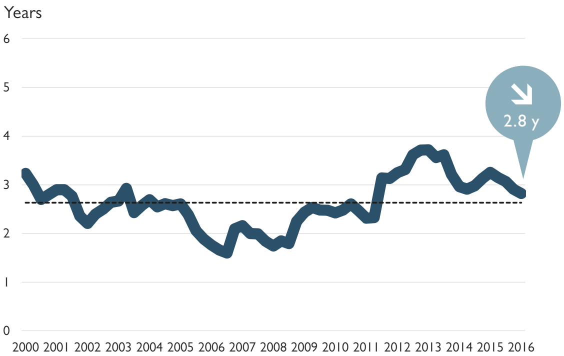
Listed sector Q1 average fixed credit term[3]



The average fixed credit term decreased from 3.4 years in Q4 2015 to 3.3 years in Q1 2016, marking a break from the trend of rising fixed credit terms. As the previous increases observed since Q4 2014 were partly a result of anticipated refinancing risk, it is possible that the listed sector believes that their current fixed credit terms sufficiently reflect refinancing risk. Nevertheless, the average fixed credit term of 3.3 years is still well below the historical average of 3.9 years.

3 Average maturity referring to interest bearing debt.

Listed sector Q1 average fixed interest term[4]



-------- Average 2000–2016

In Q1 2016, the average fixed interest term decreased from 3.0 years to 2.8 years. As such, the listed sector's average fixed interest term is fast approaching the historical average of 2.6 years. Following a small peak in Q2 2015, the average fixed interest term has decreased for three consecutive quarters, falling from 3.3 years to the current 2.8 years. The falling fixed interest terms suggest that the surveyed companies do not expect interest rates to increase 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 Q1 2000.

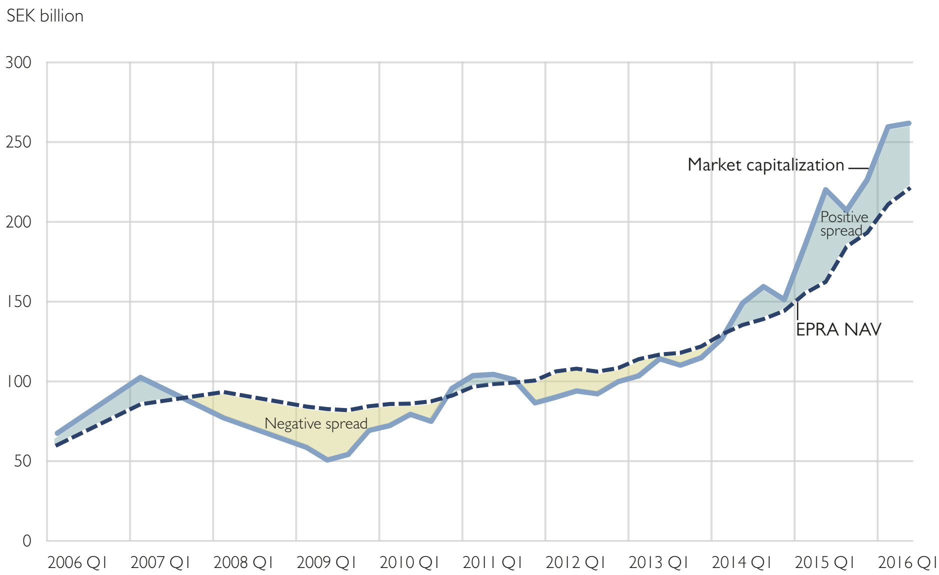
The purpose of the CREDI Indices is to track trends and changes in real estate financing by aggregating publicly available data.

CREDI – Common shares

Following a turbulent 2015 which saw the OMX Stockholm 30 Index fall throughout the latter half of the year, the Swedish stock market has stabilized somewhat in 2016. In line with the development on the stock market, the market capitalization of the listed property sector has seen only a minor increase, while market premiums have decreased. The sector's market premium was 19 per cent at the end of the first quarter of 2016, down from 36 per cent year on year. The reason for this decrease in the market premium is that market capitalization has increased at a lower rate than EPRA NAV, causing the difference between the two to decrease.

The market capitalization of the property companies on Nasdaq Main Market has increased from SEK 260 billion in Q4 2015 to SEK 262 billion in Q1 2016, which is a much smaller change than we have witnessed in recent quarters. The property companies' EPRA NAV, on the other hand, increased from SEK 211 billion in Q4 2015 to SEK 221 billion in Q1 2016, up 4.74 per cent. Accordingly, market premiums appear to be contracting in the property sector. Nevertheless, the stock market still values properties higher than the direct property market, and the current positive spread of 19 per cent is still very high historically.

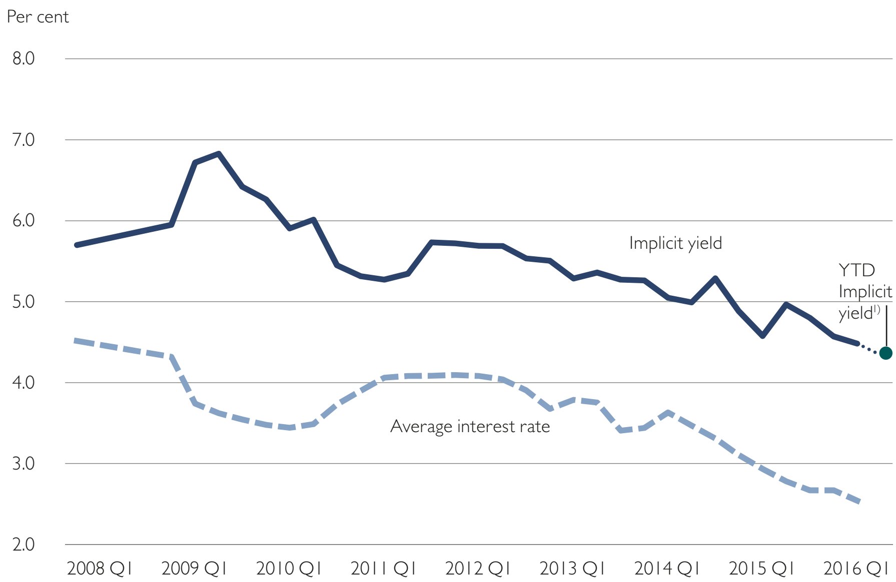
Premium or discount – market capitalization as share of EPRA NAV



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 among the listed property companies on Nasdaq Main Market decreased from 4.6 per cent in Q4 2015 to 4.5 per cent in Q1 2016, mirroring the minor decrease in the listed companies' average interest rate. Moreover, the year-to-date implicit yield, based on market data from 1 June 2016, has decreased further to 4.3 per cent. Among other things, this relationship between the listed property companies' implicit yield and their average interest rate is due to their correlation with underlying market interest rates. Furthermore, the spread between the implicit yield and the average interest rate has also fallen, from 210 bps in the fourth quarter of 2015 to 190 bps in the first quarter of 2016 and 180 bps as of 1 June 2016.

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



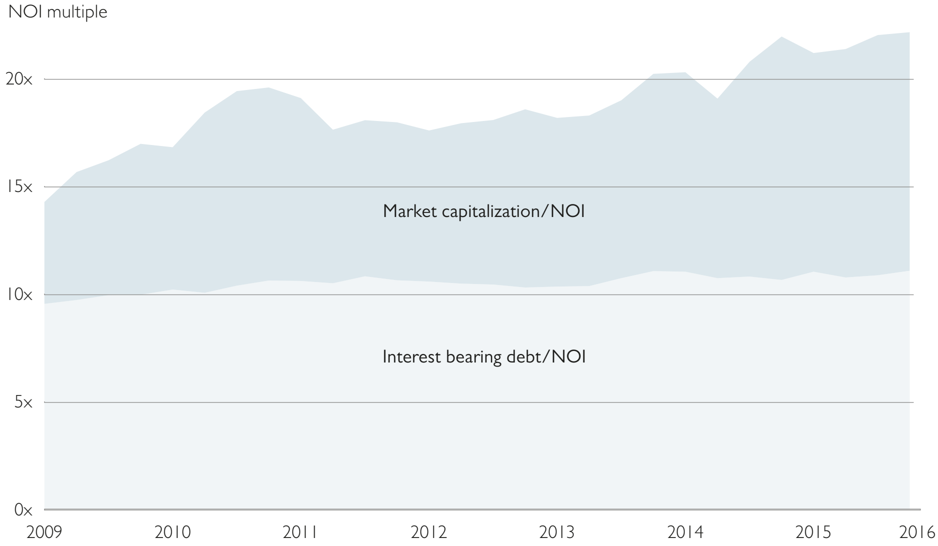
[1] Market values 2016-06-01 and Q1 2016 EPRA NAV.

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.

The listed property sector's interest-bearing debt has increased from 9.6 times its net operating income in Q2 2009 to 11.1 times its net operating income in Q1 2016. At the same time, the listed property sector's market capitalization has increased from 4.7 times its net operating income in Q2 2009 to 11.1 times its net operating income in Q1 2016. As such, the proportion of interest-bearing debt to net operating income has been relatively stable over the past seven years, while the proportion of market capitalization to net operating income has more than doubled. One potential reason as to why market capitalization has increased at a much higher rate than interest-bearing debt is that banks have become more restrictive with their lending since the financial crisis, while the stock market is more inclined to value net operating income higher in times of low interest rates and a growing economy.

Interest-bearing debt and market capitalization in relation to net operating income



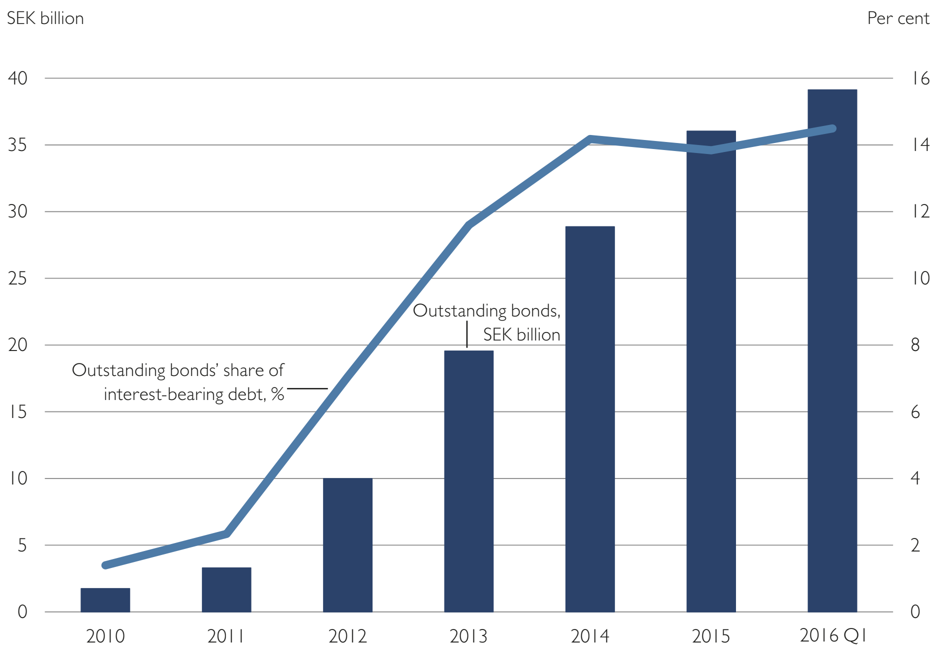
Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Bonds

Slight increase in outstanding bonds' share of interest-bearing debt.

Since the year 2010, corporate bonds have been increasingly used by the listed property sector. Six years ago, bonds were only a small share of the listed companies' interest bearing debt, but by the end of 2012 corporate bonds had started to make up a significant share and accounted for approximately 7 per cent of the interest-bearing debt. The trend of bonds representing an increasingly large share of the company's interest-bearing debt continued in 2013, and in the first half of 2014 unsecured and secured bonds comprised almost 14 per cent of the interest-bearing debt. However, in 2015, the trend reversed somewhat as the share dropped below 14 per cent. In the first quarter of 2016, however, outstanding bonds' share of interest-bearing debt increased to 14.5 per cent. Currently the amount of outstanding bonds for the listed property sector amounts to SEK 39 billion.

Outstanding bonds

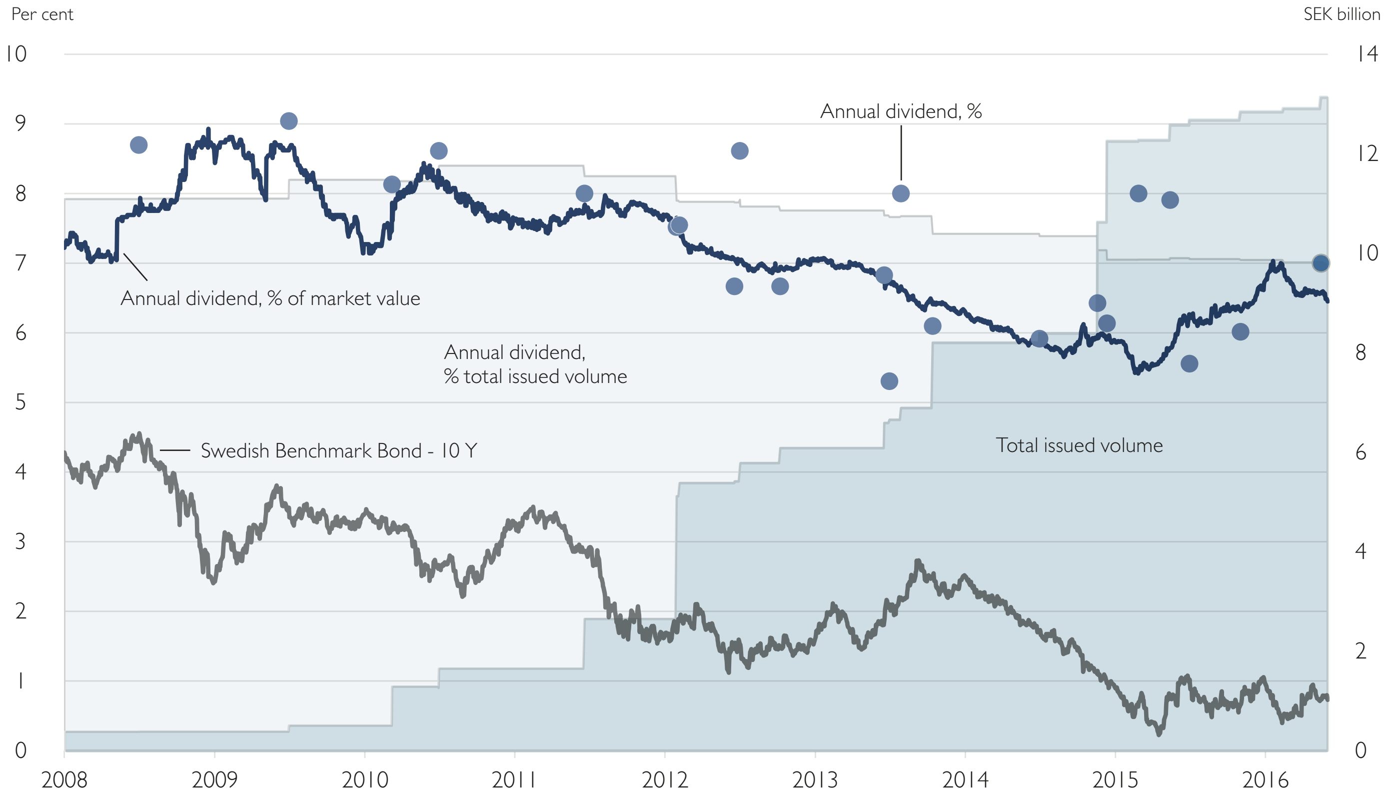


Note. Property companies on Nasdaq OMX Nordic Main Market.

CREDI – Preference shares

Following an extended period of frequent new issues of preference shares, the demand for this class of shares in the property sector has declined. Indeed, Oscar Properties' new issue of Class B preference shares in May 2016 was the first issue of property-related preference shares on Nasdaq OMX Nordic Main Market since November 2015.

Property companies' preference shares on Nasdaq OMX Nordic Main Market



Over the past couple of years, preference shares have been popular among property companies and shareholders alike. In times of low interest rates, the relatively high fixed dividends made preference shares an attractive financing instrument. However, during the past 15 months the market has revalued preference shares and their risk premiums, and the property companies' ability to choose whether or not to redeem shares has increasingly been viewed as unfavourable. Accordingly, the price of preference shares has fallen, resulting in higher annual dividends in relation to market value.

Following a new issue of preference shares by Oscar Properties, the total issued volume of preference shares on Nasdaq OMX Nordic Main Market amounts to more than SEK 13 billion. However, since the jump in the total issued volume between 2014 and 2015, the financial market has increasingly priced in downside risks. As a result, the annual dividend in relation to market value increased from 5.4 per cent in February 2015 to 7.0 per cent in February 2016. Interestingly, between February and March this year the average annual dividend fell to approximately 6.6 per cent where it remained for more than two months. However, in the end of May the average dividend began to fall, and as of 1 June 2016 it is 6.45 per cent.

Due to the slow activity in the primary market, where the most recent issue of property-related preference shares on Nasdaq OMX Nordic Main Market was carried out in early November 2015, it has been difficult to estimate the market conditions for preference shares. However, in May 2016, Oscar Properties issued SEK 225 million in Class B preference shares with an annual dividend of 7 per cent. In general, a new issue of preference shares has to be offered at a higher annual dividend than comparable shares, giving investors an incentive to purchase the new shares. However, at the time of the announcement and issue of the Class B preference shares, Oscar Properties' existing preference shares were yielding approximately 8 per cent per year. The reason why the market was willing to purchase preference shares with a lower annual dividend is that the terms for the Class B preference shares were viewed more positively. Holders of the preference shares will have the right to request that the shares be redeemed by the issuer for SEK 500, which is the price at which the preference shares were issued, thus making the instrument much closer to debt to the holder of the preference shares. Furthermore, Oscar Properties has an option to increase the dividend per share in order to ensure that the instrument remains attractive.

CREDI – Catella's view through the looking glass

Average yields have already left the bottom in line with weakening credit sentiments – but prime yields will remain at historically low levels.

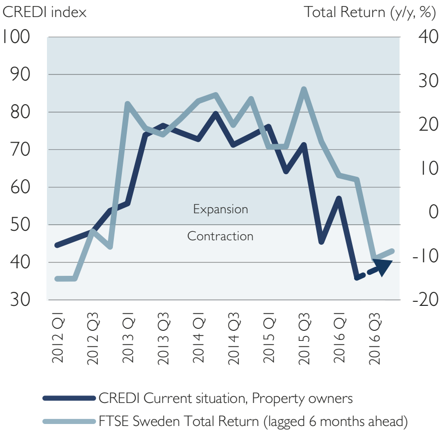
In the most recent CREDI survey, the Main index for property owners headed back into contraction territory, and although the Main index for banks improved somewhat in the same survey, their Main index remained below the 50.0 turning point.

Over time both the Swedish equity market and GDP growth have correlated with the CREDI index. The equity markets had a turbulent start of 2016, but has stabilized since March due to a weaker dollar and more dovish central banks. The recent year's decline in the CREDI index is well in line with the overall development on the equity market. Since mid-2015, however, the CREDI index has decoupled from GDP growth, which grew at historically strong 4.2 per cent in Q1 2016, driven by household consumption and investments. The Federal Reserve is now getting closer to an interest rate hike and the IMF has gradually lowered their forecasts for global GDP growth. All in all, global economic growth will most likely be slow in 2016–2017, and the stock market is indicating a slowdown in the Swedish economy during the second half of 2016.

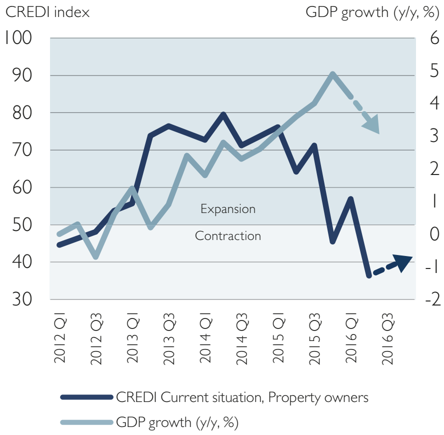
Catella's view is that the credit cycle peaked during the spring of 2015. The weakening credit sentiments take hold despite recent months' tightening of the previously elevated credit spreads. The past year's difficulties in issuing corporate bonds have also started to show signs of subduing in recent months. The weakened credit sentiment on the property market is most likely a sign of increased risk averseness and unwillingness among banks to increase their property exposure. Yields for commercial properties are at historically low levels, but have edged up somewhat since February. Both average yields and transaction volumes are strongly correlated with GDP growth. If the Swedish GDP growth slows down during the second half of 2016, the 12-month transaction volumes will most likely move towards the historical average of around SEK 115 billion.

This would result in increasing yields for commercial properties in secondary locations in the major cities, and properties in smaller cities in particular. However, low or negative bond yields, falling commodity prices and a volatile stock market will make high-quality properties in Swedish growth cities highly attractive for investors in the coming years.

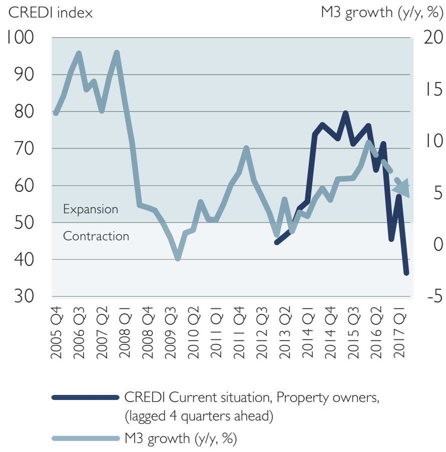
FTSE Sweden and CREDI Current situation for property owners



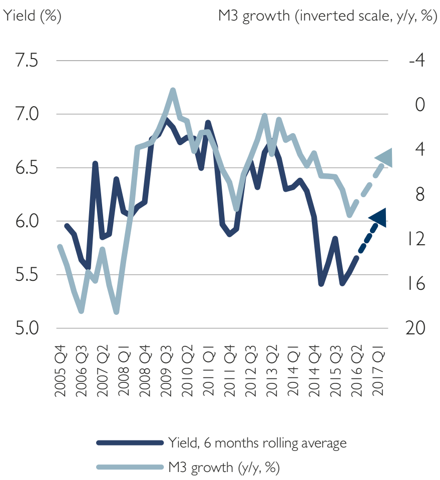
GDP growth and CREDI Current situation for property owners



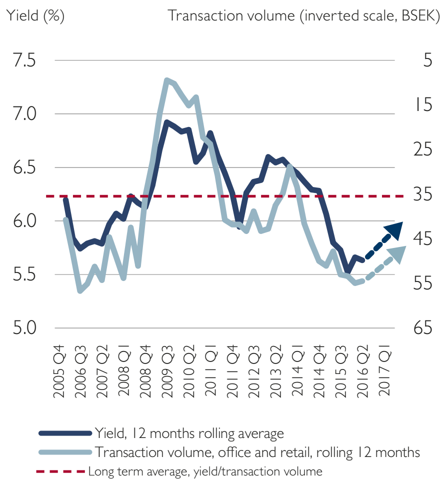
The M3 growth and CREDI Current situation for property owners



The M3 growth and average yield*



Yields and transaction volume*



Yields and GDP growth*

Source: FactSet and Catella

* Yields are based on historical office and retail transactions in Sweden. Yields are either verified or estimated by Catella. Transaction volume does not include Castellum's acquisition of Norrporten, which comprises properties to a value of SEK 22 billion.

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Contacts

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

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

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

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HQ: Birger Jarlsgatan 6, Stockholm
info@catella.se
catella.se/corporatefinance