



Weekly Letter:

# The Swedish property market is under fire. Time to buy?

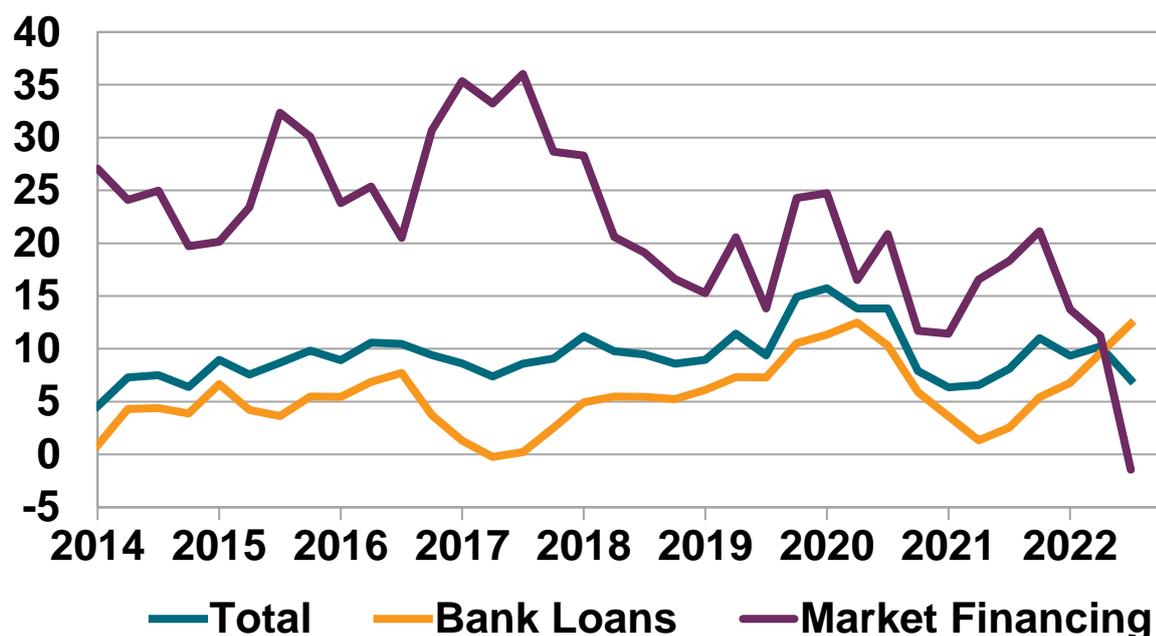
21 December 2022  
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## Deleveraging in the property sector

- The Swedish property market is under fire, and property owners are selling to release cash. As the bond market is frozen, the burden on the banking sector will increase even more
- It is time to buy when it is dark. Can it be darker, or is it time to buy?
- We still believe in a Santa Claus rally. As we mentioned before, Santa Claus typically comes late in December (as he should do)
- We wish you all a Merry Christmas and a Happy New Year!

Swedish real estate companies' bond loans have grown from SEK 160 billion in 2014 to SEK 800 billion by 2022, which means that the share of bond loans in total property lending has grown from 16 to 40 per cent.

### Annual growth (in %)- Lending to Swedish Property Sector



At the same time, credit spreads on bonds have doubled. Real estate companies account for 50% of bond lending volume in the Swedish market, making it more financially stressed than the bond markets in Denmark and Germany.

This has triggered financial stress for Swedish real estate companies, with SBB initially in the spotlight following a significant short-selling action against the SBB stock led by

the Viceroy consortium from the United States. This storm has subsided after SBB sold a 49% stake in Educo, a community real estate company with properties of SEK 45 billion, to the Canadian institution Brookfield.

Other Swedish property companies have also started divesting properties to free up capital. and raise their credit ratings to obtain new financing. Corem recently sold a logistic property portfolio to Blackstone for SEK 5.3 bn. Fewer development projects, such as in Castellum, serve the same purpose of improving the cash flow and liquid funds.

An equally important event in the sector was when Rutger Arnhult, through his holding company M2, was forced to sell a controlling stake in Castellum for SEK 4.6 billion to Akelius as of 6 October. This meant a change of power in one of Sweden's leading real estate companies. Shortly thereafter, Roger Akelius pushed through the cancellation of the dividend to Castellum's shareholders to strengthen the group's liquidity. This confirms that the private holding companies are or have been surplus leveraged rather than the property companies.

On Friday, 16 December, Balder announced it had made a directed share issue to AMF of SEK 1.8 billion. Balder will use the proceeds to repurchase hybrid bonds. The rights issue was only 3% dilutive but was made at a low valuation of Balder (34% discount on NAV and p/e 11x).

### **Comparison with previous property crises since 1990**

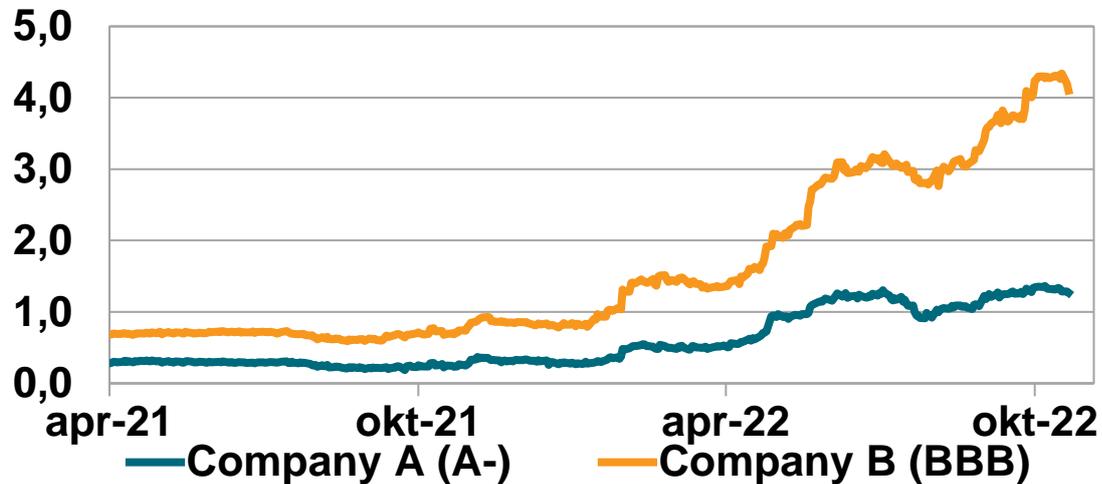
The 1990s crisis in Sweden was exceptional, with leverage ratios in companies of 80-90% and negative cash flows before interest rates started to rise. Today the leverage ratio is around 50%.

It was mainly foreign owners in Sweden (from the UK, Denmark, and Norway) who were overleveraged and had to divest properties in 2008-2011. They paid higher interest rates than Swedish owners with the same mortgage.

## Deleveraging in the property sector

Many properties have been put up for sale to the Swedish transaction market since spring 2022. Most of this still needs to be sold.

### Higher credit spreads (in %) that vary with credit rating

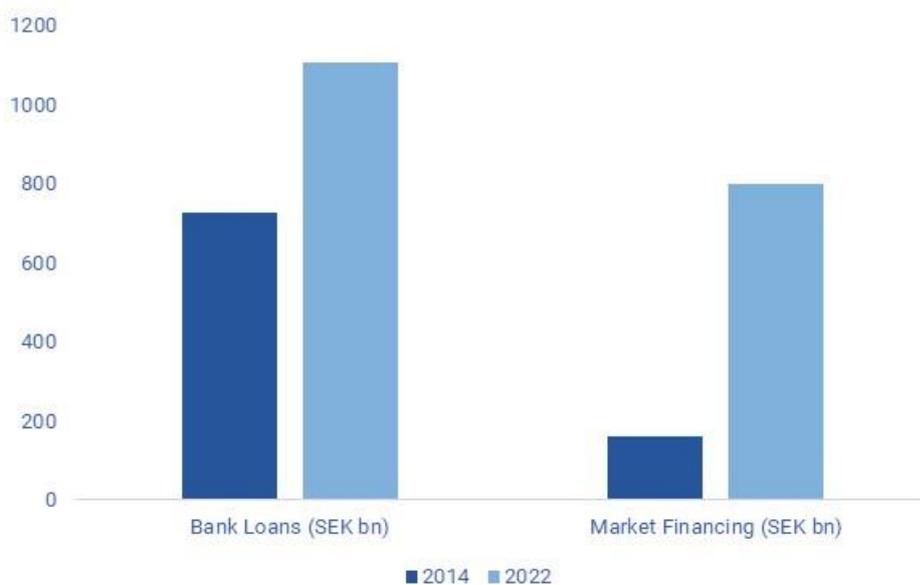


Source: Finansinspektionen Stability Report 2022:2.

One similarity between all three property crises (1990, 2008 and 2022) is that liquidity in the bond market was drained on all occasions.

Nordic banks have transferred peak lending to the bond market after the Lehman crash in 2008. The rapidly growing and now very tight Swedish bond market is specific to 2022.

### Bond Loans and Market Financing (SEK bn) 2014 and 2022



Sources: Company reports, Carlsquare, Finansinspektionen.

## Deleveraging in the property sector

In 2008, Swedish real estate companies paid 4-5% interest. Today, the average for 38 listed Swedish real estate companies is a 2.3% interest rate, though in an upward trend. On average, Swedish property stocks are traded at a 37% per cent discount to their NAV. Given an asset/equity-gearing of 2.2 times, the stock market discounts a 16% price drop in property prices.

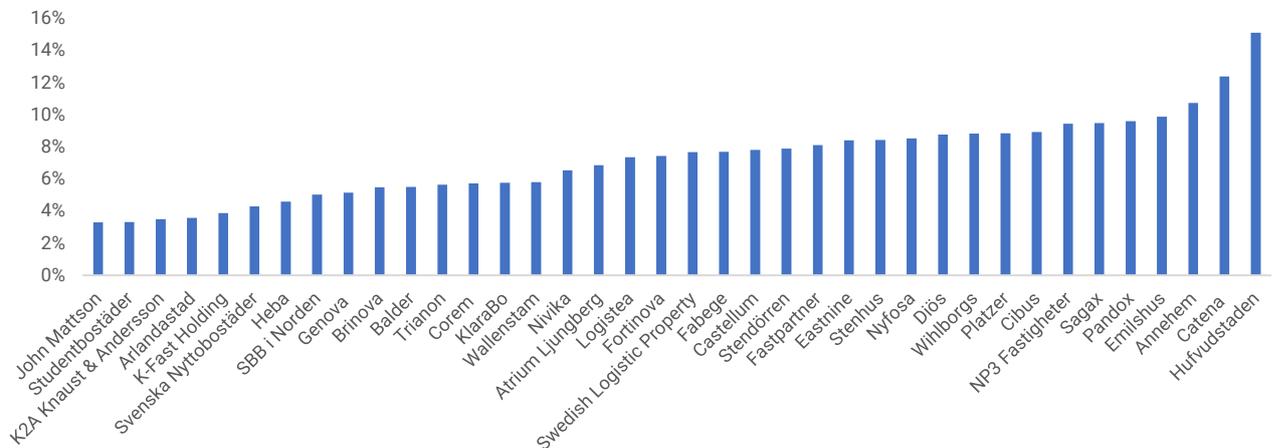


Source: Carnegie, Millstream Market Data AB.

Most listed Swedish real estate companies can withstand 4-5% interest rates before the property management result becomes negative (residential) and 6-15% for office and retail space.

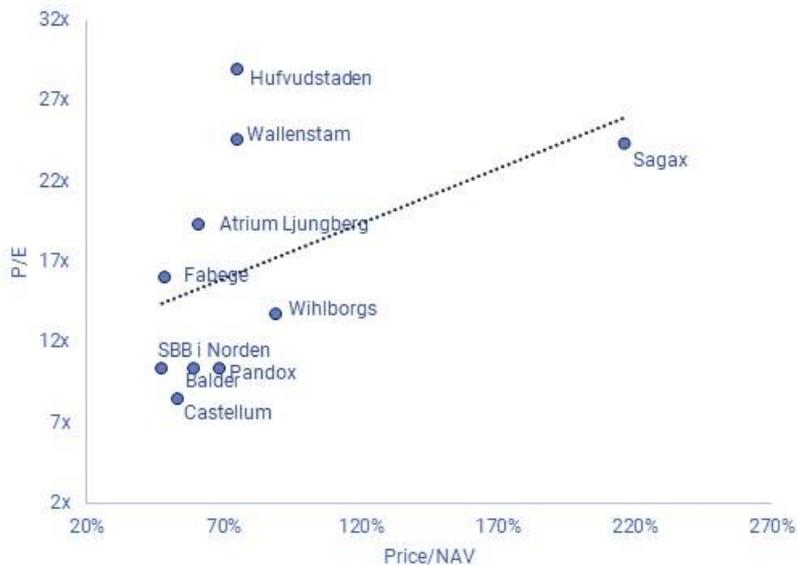
Of the ten companies on the far left with the lowest interest rates, six are residential companies, and three others have a share of residential properties in their portfolios.

### Property companies by interest rate when the result becomes zero



While rental increases will be around 9% for commercial premises from 1 January 2023, residential rents are up by only 3-4%, according to some recent local agreements. This means that residential companies, which initially are most sensitive to changes in interest rate levels, will receive lower rental increases compensation in 2023.

### Valuation of ten major property stocks



In the above chart, we have plotted the valuation of ten listed real estate stocks with the largest market capitalisation by p/e ratio on the y-axis and price/net asset value on the x-axis. Earnings in the P/E ratio are measured on net operating income minus financial expenses from the property portfolios before any value changes. In general, residential companies (although few of these in this graph) are valued highest in the sector in relation to p/e ratios, while Balder, Castellum and SBB are among the lowest. This is because these companies have a high proportion of bonds.

Usually, Balder, Castellum and SBB should be valued at a premium to the sector since they are larger companies. Given that these three companies have taken measures to strengthen their balance sheets, all these shares are considered attractively valued.

## Deleveraging in the property sector

But regardless of valuations, stepping into the property sector is a matter of timing. A rule of thumb is to only buy into distressed sectors after they have broken up through some traditional targets as 20/50- or 200-day moving average. From that point of view, it is too early to buy property companies. From a risk aversion perspective, waiting for that day to happen is better.

But for a more risk-positive view, doing some bottom fishing can be an exciting exercise.



The Balder stock has been falling from 120 SEK to 47 SEK. It has broken the falling trendline, which is positive. It may have found a bottom as MACD has also increased. From a technical perspective, the stock is attractive but be aware that the whole sector can have another leg down if more companies face problems. It is a wall of refinancing in coming years that can create new volatility in the market.

Tight stops are recommended for all transactions in this sector currently under fire.

## Deleveraging in the property sector



The SBB share has a view like Balder.



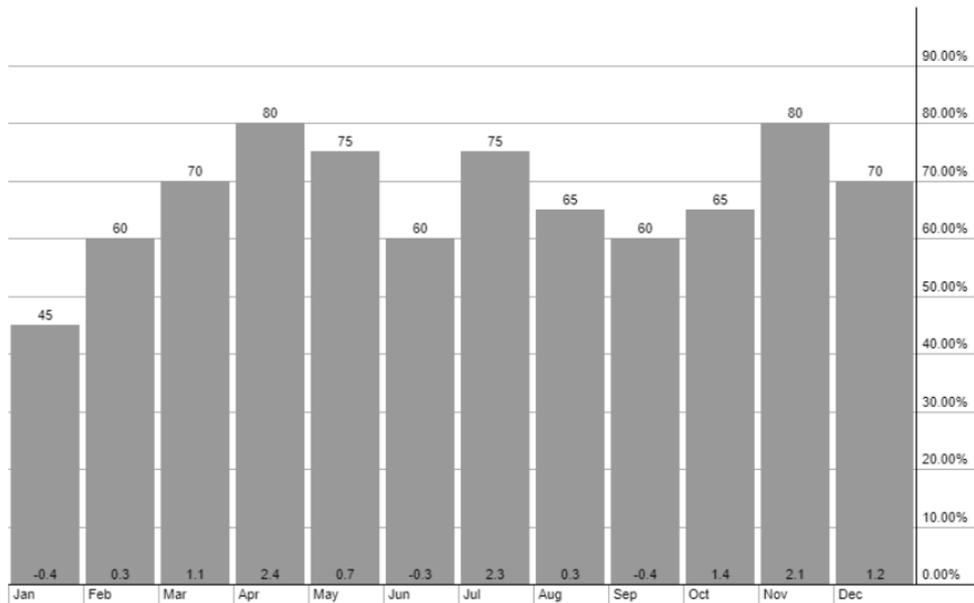
Castellum is currently the least interesting from a technical perspective. The sellers still dominate the stock. But also, in Castellum, MACD is trending slightly upwards, giving a positive divergence.

**MOMENTUM**

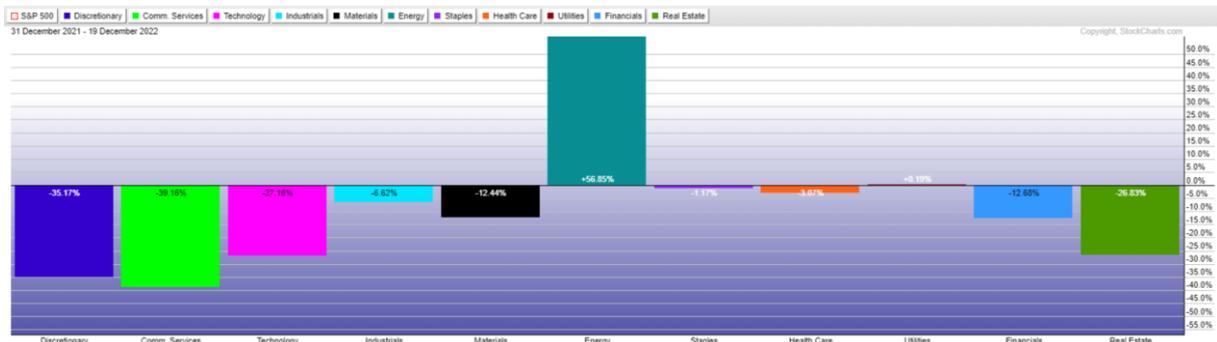
It is a well-known season effect that the stock market usually has a rebound in the last weeks of the year.

Two effects are typical: the focus is on winning stocks, as fund managers will be interested in showing portfolios with good-performing stocks when the portfolio value goes public. But in a stock rebound, an opposite strategy can also be attractive, i.e., buying the year’s worst performers as they are the laggards...

% of Months in Which SPY Closed Higher Than It Opened From 2003 to 2022



Looking at the statistics, there are typical seasonality effects on the stock market. We don’t jump into the explanations, but usually, it is much money at work last weeks of the year to fill the gaps and do some window dressing before the clock stops at year-end.



## Deleveraging in the property sector

Energy stocks are the clear winners in the S&P500 index for the year to date. At the bottom, we find IT/Communications Services and Discretionary consumer stocks.



From a long-term perspective, the market is in an uptrend but has been falling since the inflation fear kicked in. We don't see any bottom yet. We are still waiting for Fed and the other central banks to change their policies. The global market is still drained of liquidity.

That said, Santa Claus has plenty of room to play the last ketchup for the year's end.

# Deleveraging in the property sector



In the daily chart, S&P 500 is trading on support from the Fibonacci levels. A new visit to the former bottom is in the cards. But now it is to take one day at a time and stay nimble for all possibilities. Happy trading!

## Week Ahead

### Company reports on Wednesday, 21 December: Aurubis.

German Consumer Confidence in January at 8.00 CET kicks off Tuesday's macro agenda. The December Economic Barometer from the National Institute for Economic Research in Sweden follows. Canada releases the November CPI at 14.30 CET. Then follows the US current account balance in Q3, household confidence indicator in December, existing home sales in November and oil inventories (DOE) weekly statistics.

### Company reports on Thursday, 22 December: Truck Sales Western Europe in November from Acea.

The morning starts with November PPI and retail sales from SCB (Sweden) and UK Q3 GDP. From the US, we get Q3 GDP, weekly jobless claims, leading indicators in November and the Kansas City Fed Index in December.

### Company reports on Friday, 23 December: -

Today's first news comes from Japan, at 0.30 CET CPI in November and at 0.50 CET minutes from the Bank of Japan. Spain's Q3 GDP will be released at 9.00 CET. In the afternoon, Canada's GDP for October will be published. From the US, we get residential construction, private consumption and inflation, durable goods orders, sales of new homes in November, and the Michigan index in December.

Monday, 26 December: The Nordic, Frankfurt, Paris, London, US, Toronto, and Hong Kong stock exchanges are closed for the holiday season.

### Company reports on Tuesday, 27 December: -

At 0.30 and 0.50 CET comes Japan's unemployment and retail sales in November. China will follow shortly with manufacturing corporate profits in November. From the US, we get the November trade balance and wholesale inventories, Redbook weekly retail sales data, October S&P/CS and FHFA house price indices, December Richmond and Dallas Fed Indices and weekly oil inventories (API).

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