



Swedish Real Estate Equity Snapshot

Carlsquare Equity Research

29 Mars, 2023



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Equity Research

Carlsquare Equity Research has been providing commissioned equity research on Nordic companies since 2013. We have covered over 250 companies from various sectors. We also do valuation assignments for private and public companies.

Selection of companies covered

 Food supplements and distribution 	 Industrials 	 E-commerce 	 Real estate 	 Life science 	 Renewable energy
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Selection of valuation assignments

 Personal finance VALUATION 	 Payment solutions VALUATION 	 Business management system VALUATION 	 E-commerce VALUATION 	 Life science VALUATION 	 Commercial services VALUATION
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Carlsquare Equity Research, Real Estate

Bertil Nilsson heads the Carlsquare Property Research team. The team currently follow the Swedish property market closely and assesses the sector based on key figures from 39 property companies listed on the Stockholm Stock Exchange, as well as the following events in the industry. For questions on the material in this sector report, please contact Bertil Nilsson at Bertil.Nilsson@carlsquare.com.

Bertil Nilsson has been employed as a Senior Analyst at Carlsquare since 2013. He holds a Master's Degree in Real Estate Economics as a Chartered Surveyor at the Royal Institute of Technology (KTH) from 1982-1986. During 1987-2002 and from 2007-2008, he was an Equity Analyst at Consensus, Nordiska, Myrberg/Danske and Glitnir. He was also a Real Estate Portfolio Manager at Aberdeen Property Investors from 2003-2007 and from 2011-2012.

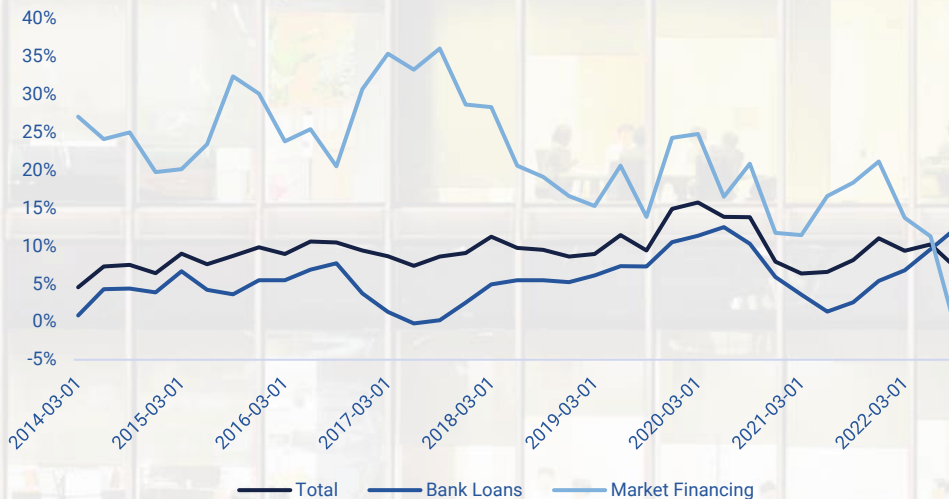
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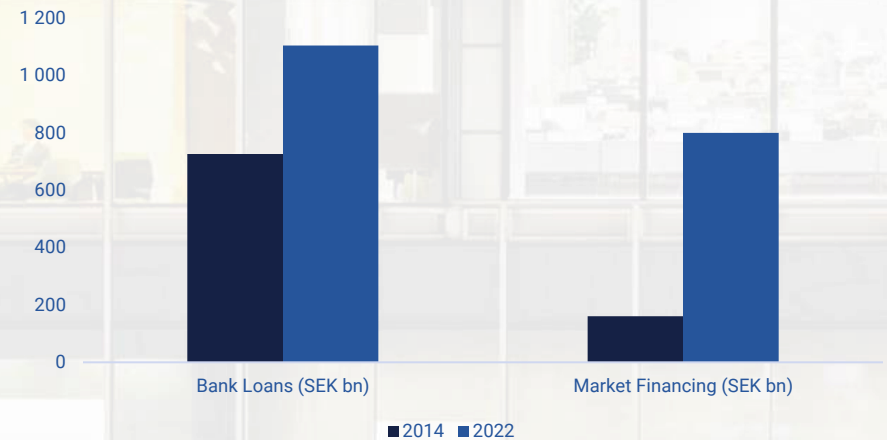
Growth in debt of Swedish real estate companies 2014-2022

- Most rising property price risks due to lower interest rates in 2014-2021 have fallen on bondholders rather than banks.
 - The share of market financing (bonds etc.) in total lending to the Swedish real estate sector is estimated to have increased from 16% to 40% in 2022.
 - Rapidly rising bond yields have meant that real estate companies must divest properties or reduce dividends to their shareholders to repay loans.
 - The fifteen largest Swedish property companies cut their dividends by an average of 23% in 2022 compared to 2021.
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- Swedish listed real estate companies have an average of about 40% bond debt compared to total lending. Balder, Castellum and SBB have around 60%, while the other companies have about 30% of bond loans.
 - SEK 306 bn in loans are due until 31 December 2024.
 - When we look at the quoted companies' Q4 2022 reports, we see that bond borrowing has decreased somewhat compared to Q3 2022 for almost all companies.

Annual Growth of financing



Financing amount 2014 versus 2022, SEKbn



How bad is it?

- The real estate sector accounts for about 50% of bond lending in Sweden.
- The Danish and German bond markets are less stressed than Sweden due to lower refinancing needs.
- Bond yields have risen similarly in all markets. However, following the recent banking turmoil involving SVB in the US, Credit Suisse in Switzerland and others, central banks have increased liquidity again to preserve the banking system. As a result, short-term interest rates have fallen again.

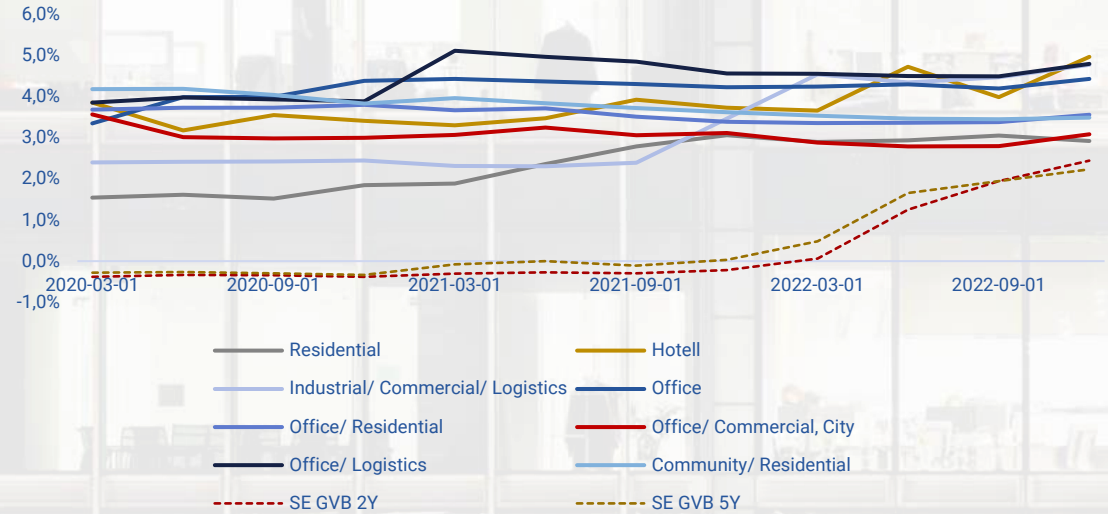
- Most listed real estate companies can withstand 4-5% interest rates before the property management result becomes negative (residential).
- The corresponding hurdle is 6-15% for office/retail space before the property management result becomes negative.
- Commercial rents have increased by some 10% on average from 1 January 2023 due to CPI clauses in the lease agreements.
- Meanwhile, there is only a 4 to 5% increase expected for housing rent from 1 January 2023 in Sweden.
- Residential property companies are thus more affected by recent interest rate hikes than those with offices and other premises.

- We will likely have insolvencies linked to bond loans. For example, there may be guarantees that trigger chain reactions.
- Real estate companies have started divesting properties to free up capital and raise their credit ratings to obtain financing.
- Fewer development projects serve the same purpose and lead to a reduced supply of new premises.
- Cancelled dividends and new issues are property companies' last lifelines at the cost of share price pressure.
- Principal owners with leveraged holdings want to avoid these options.

Property yields derived from valuations

- Property companies waited until Q4 2022 before starting to write down their property values by an average of 2.4%.
- The decline in property value is explained by individual companies and owners rather than the type of property.
- For FY2022's average reported property value change was minus 0.1%.

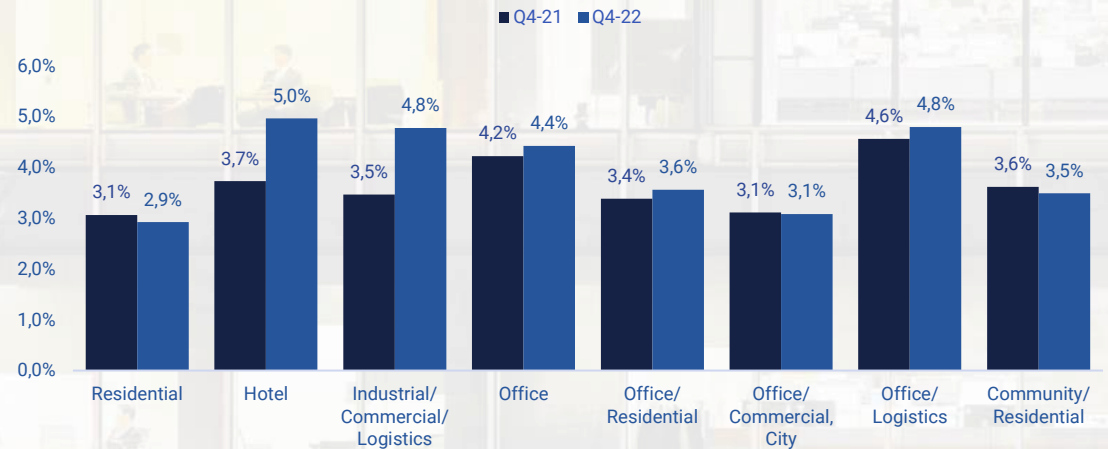
Yields on reported properties



Higher yield on industrial and lower on residential

- From Q4 2021 to Q4 2022, investors' yield requirements for industrial/logistics and hotels increased the most.
- Meanwhile, residential yields, measured in the net operating income generated, fell.

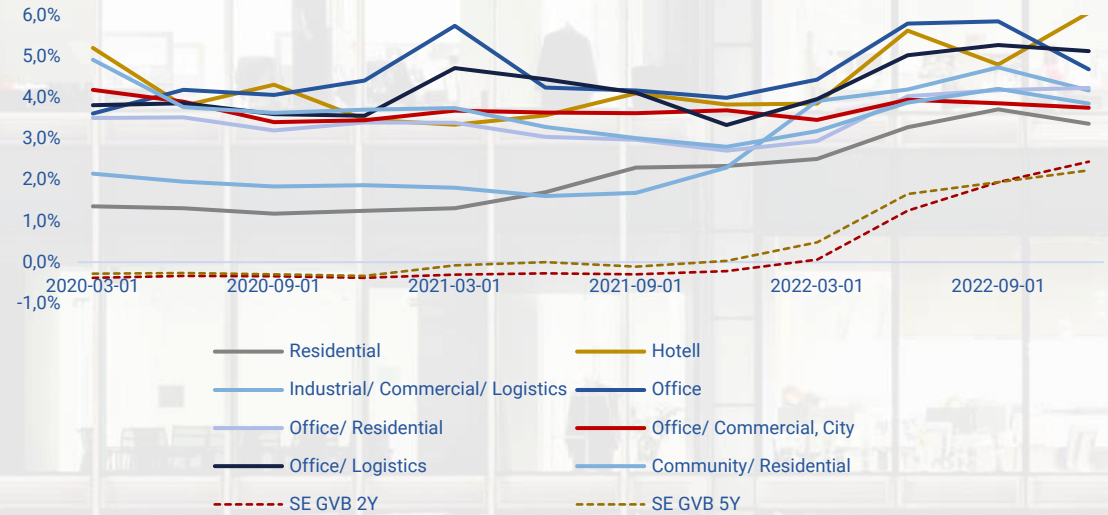
Yields on reported properties Q4-21 vs Q4-22



Implied property yields via changes in share prices

- Investors have raised residential yields the most in the sector
- Meanwhile, office yields have been flatter
- This is due to higher rent increases from January 2023 for commercial premises than residential ones.
- Lower net operating income also makes residential companies more sensitive to increased interest rates.

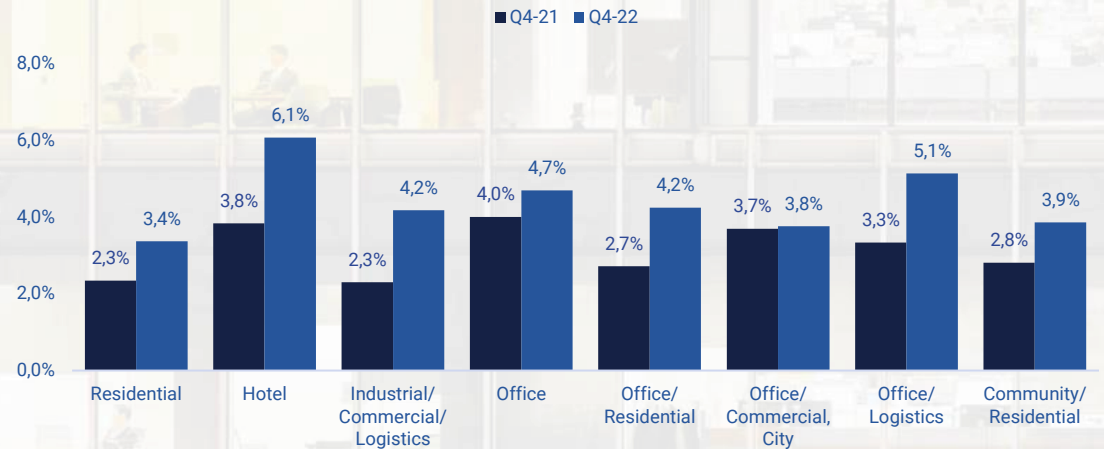
Implicit Yields



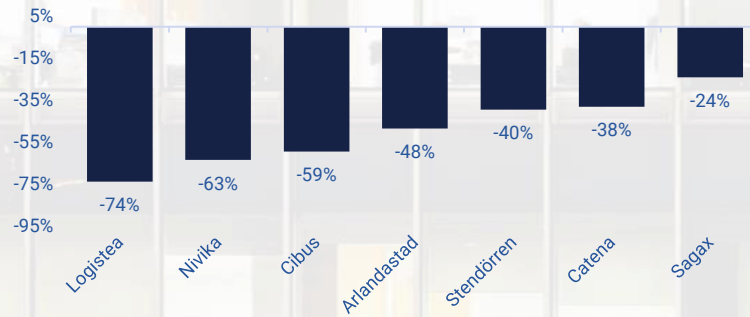
Lower equity prices led to a higher implicit yield

- Investors see the most significant demand for higher yields in hotels and office and logistics properties.
- This is probably related to the perception of rising vacancy risks.

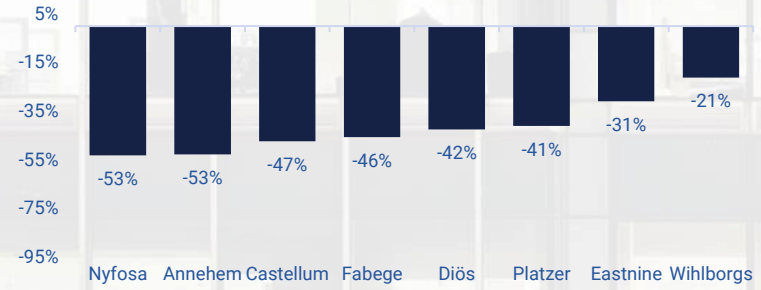
Implicit Yields Q4-21 vs Q4-22



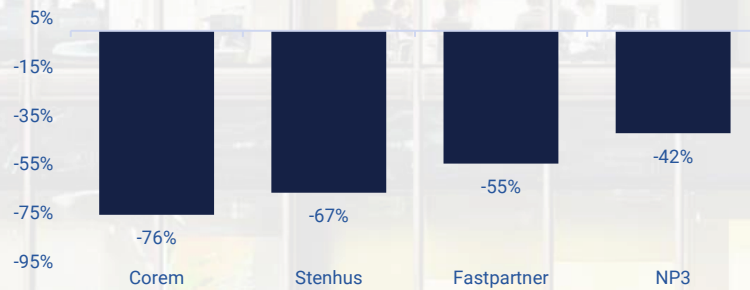
Industrial/Commercial/ Logistics



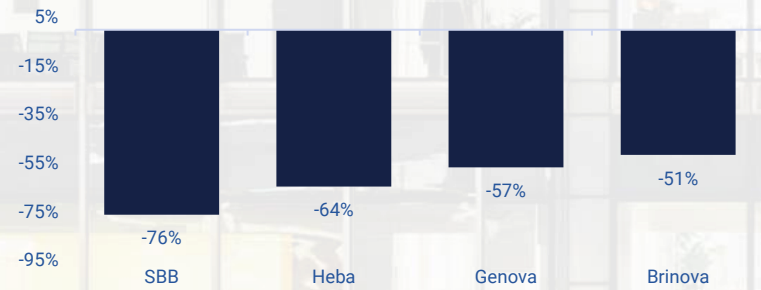
Office



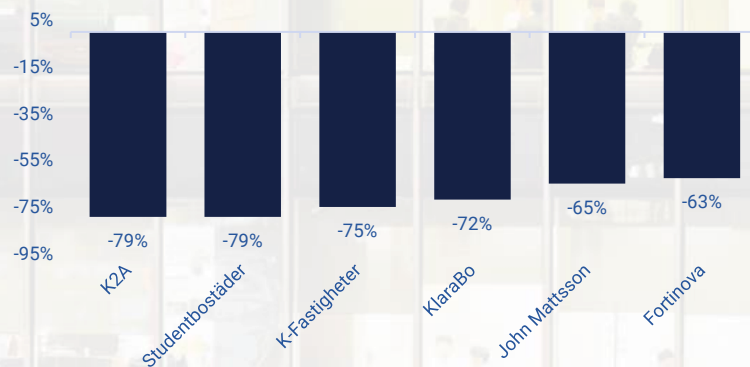
Office/Commercial, City



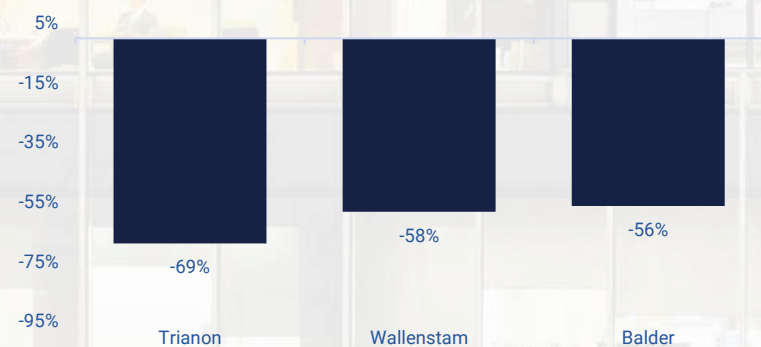
Public/Residential



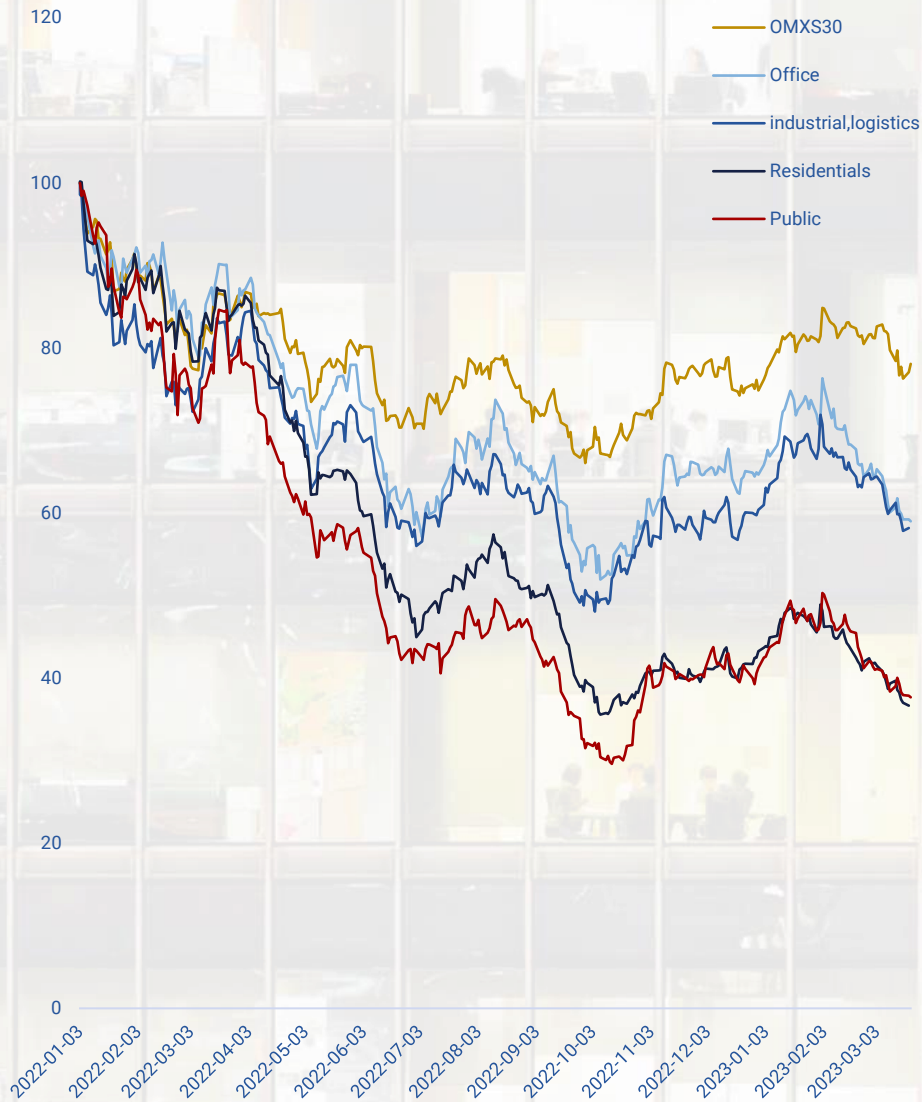
Residential



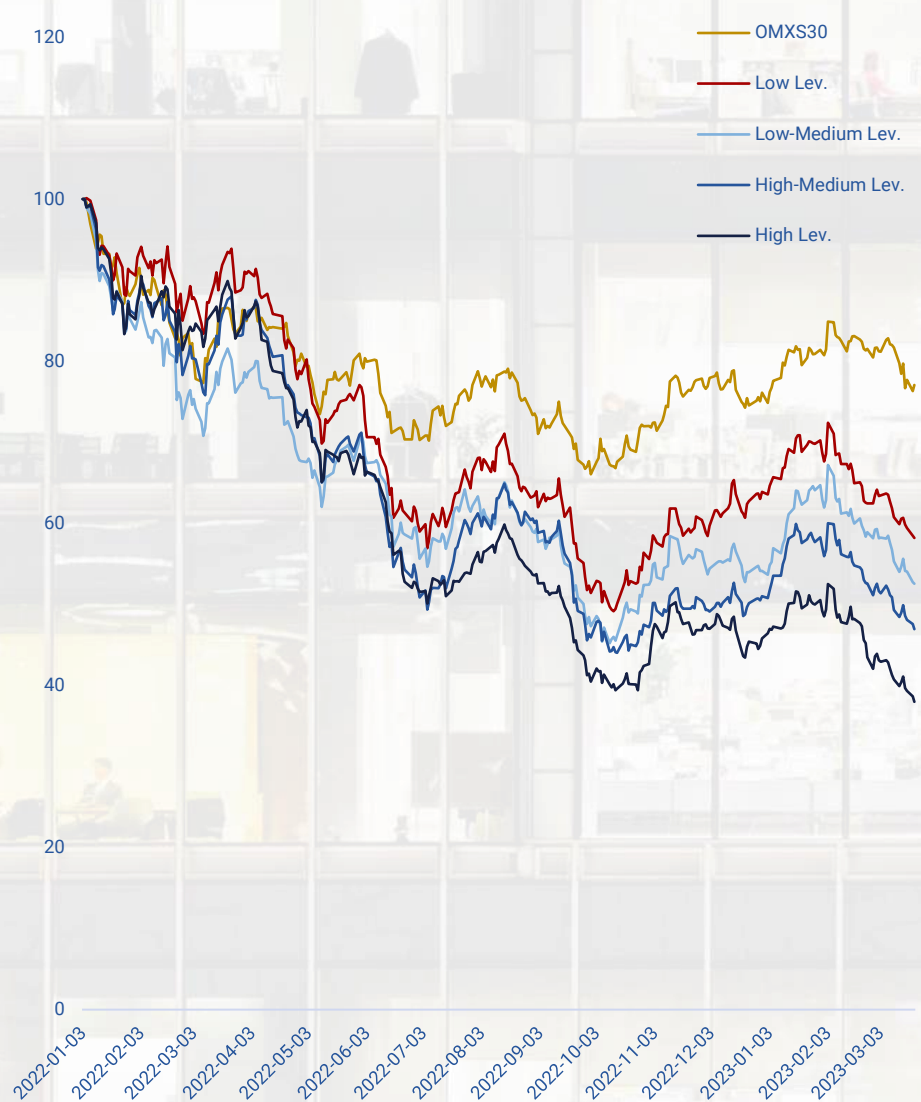
Residential/Office



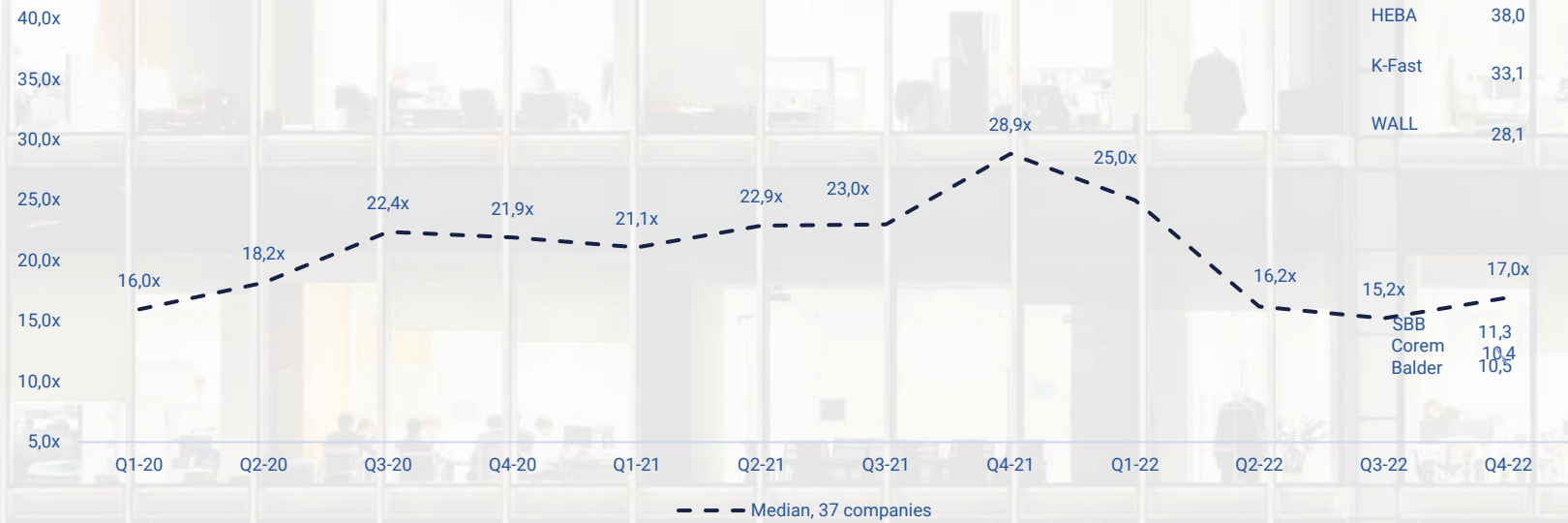
Share price performance, per segment



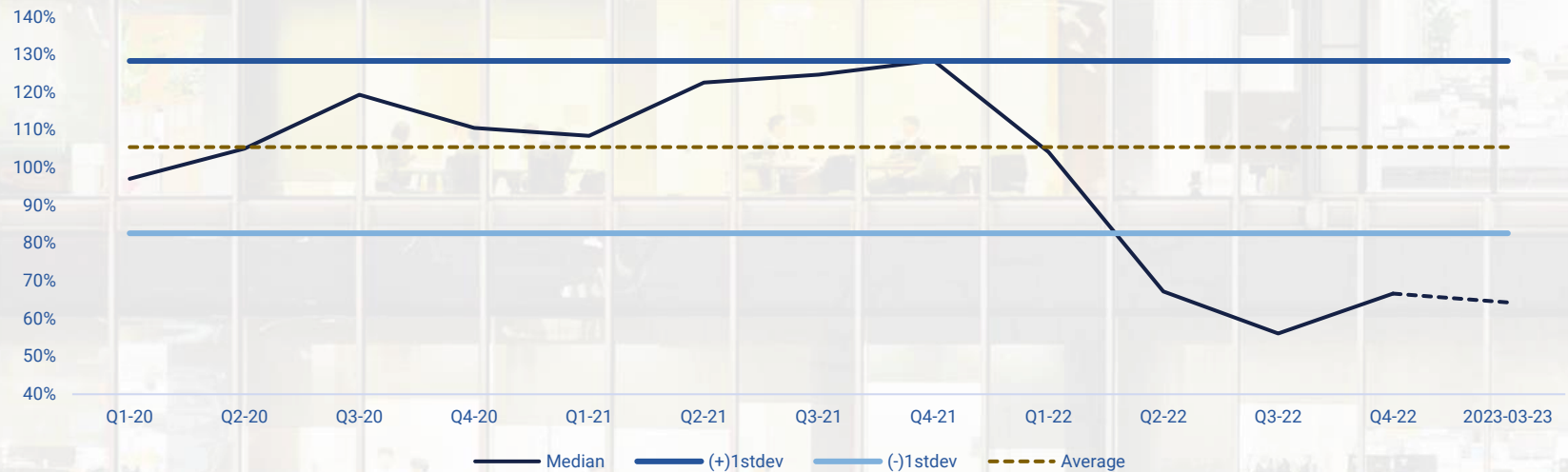
Share price performance, ranked by degree of leverage



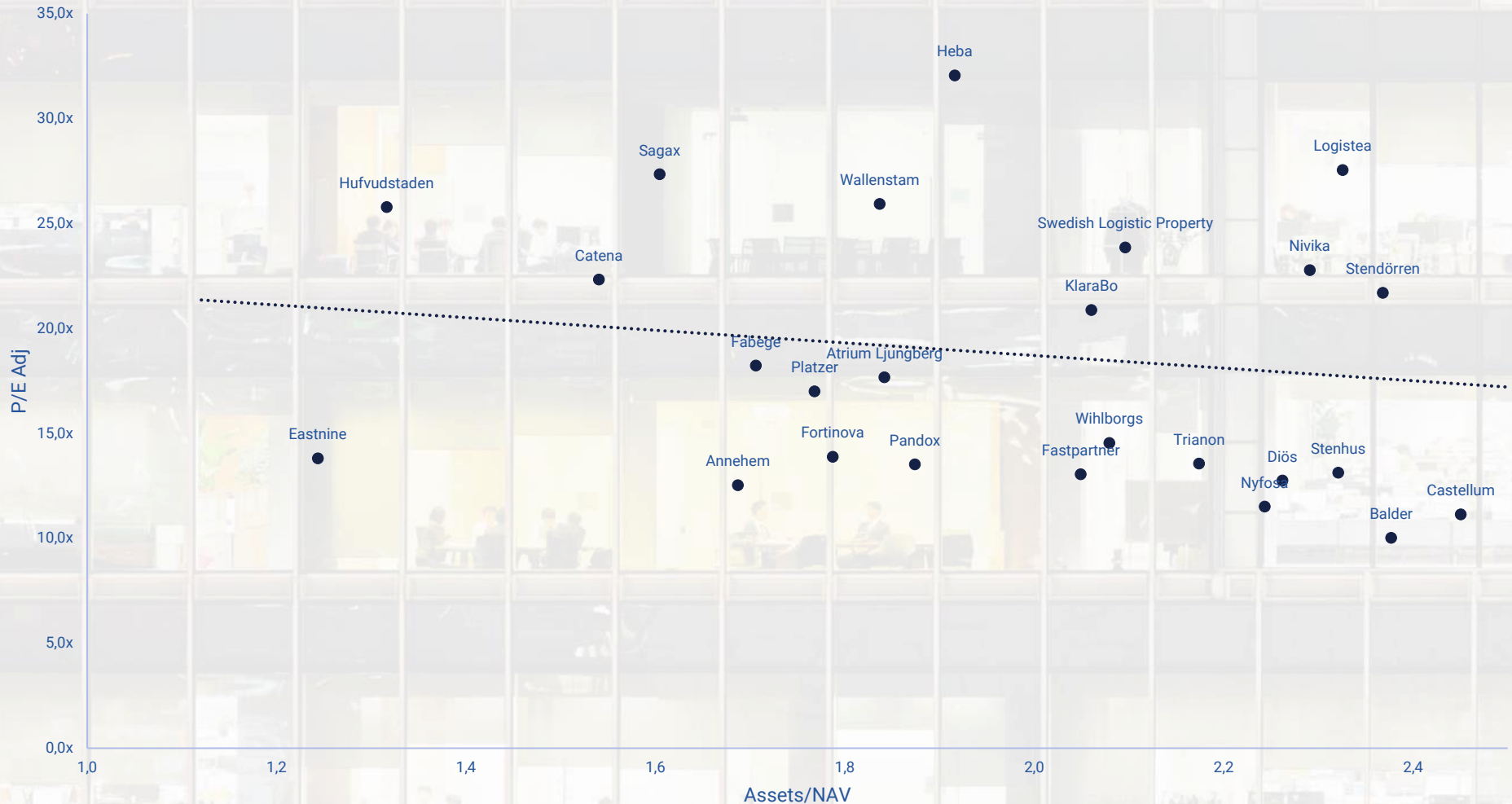
P/E Adj. (NTM)



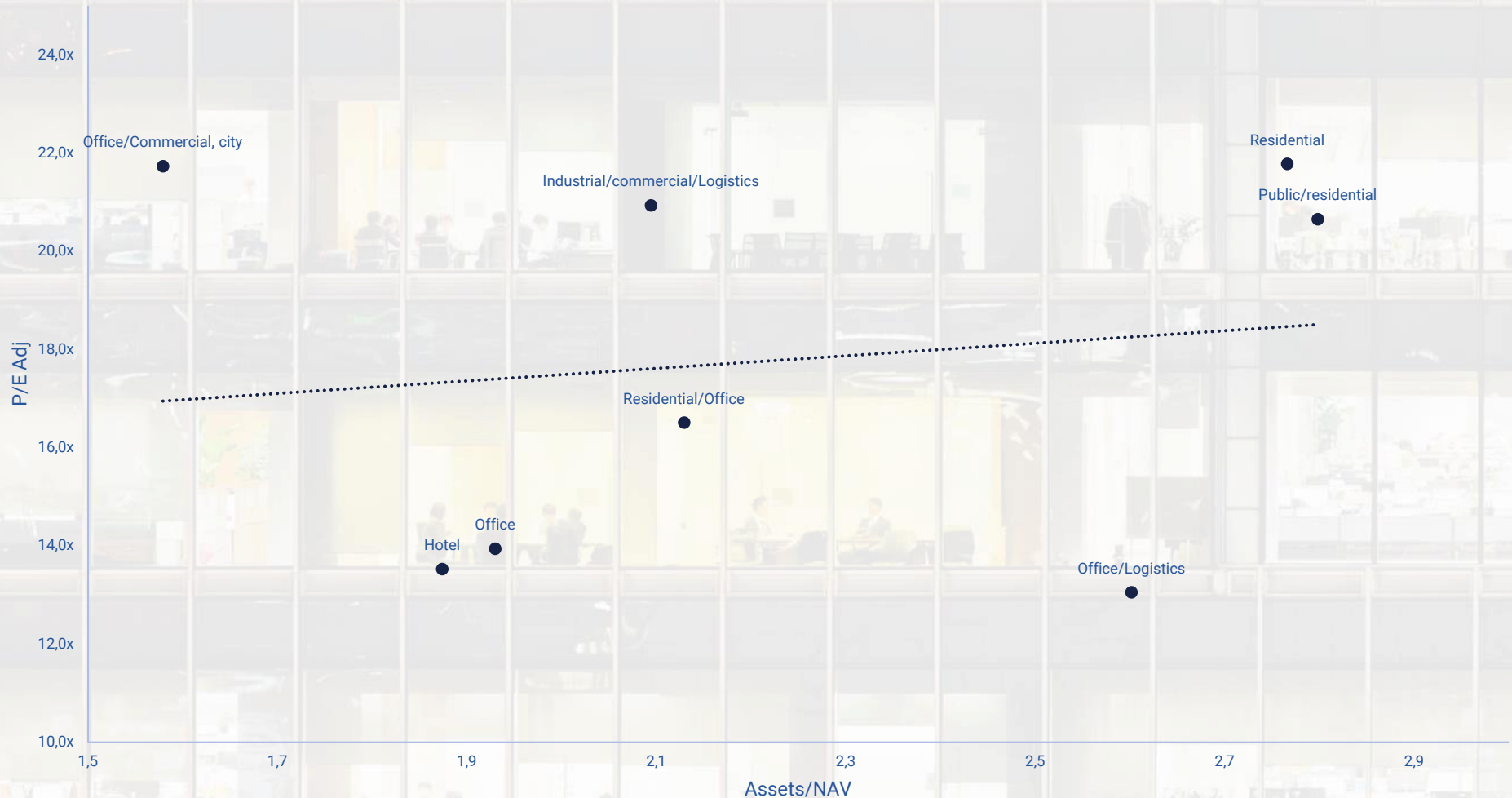
P/NAV



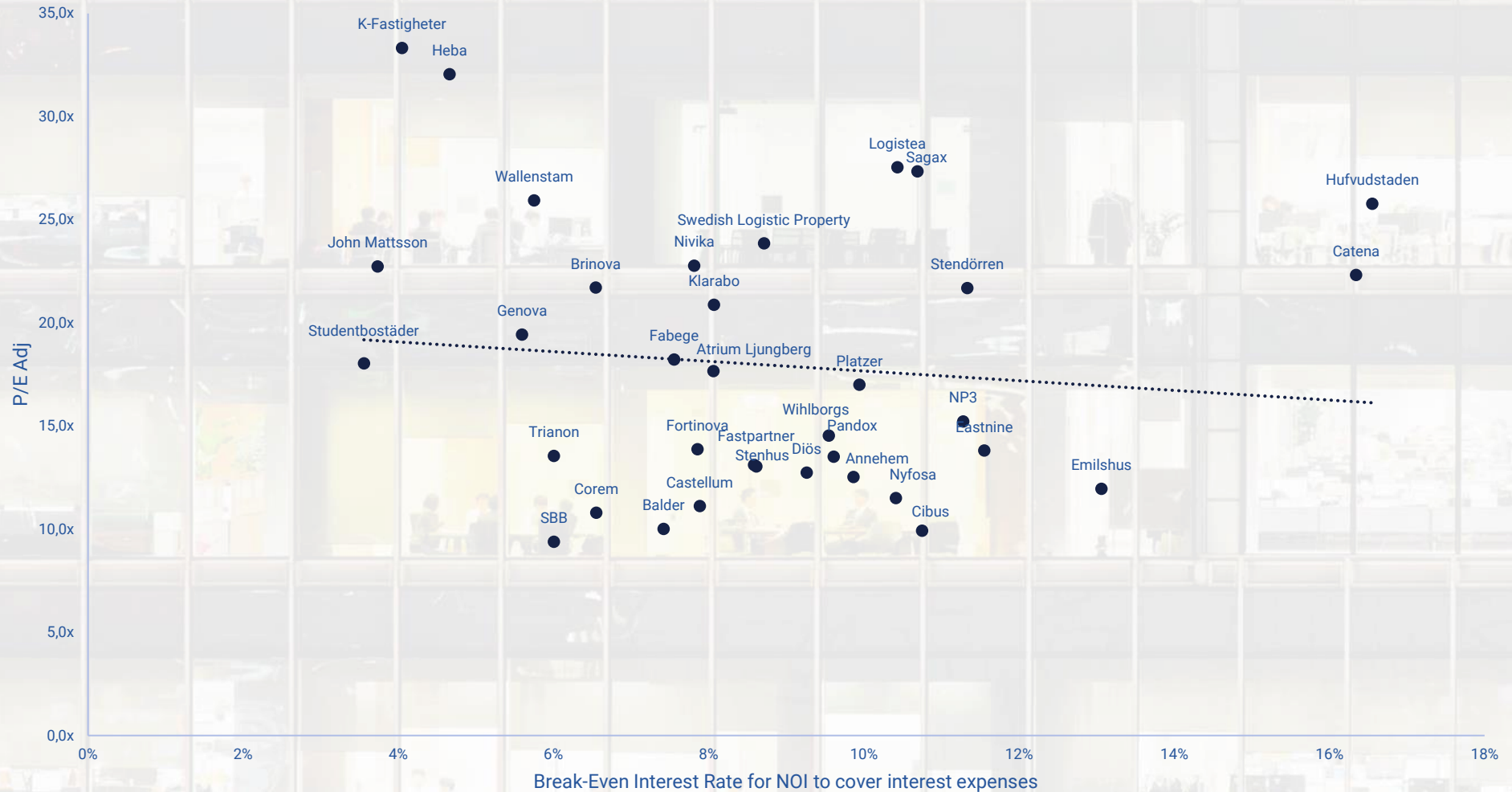
- Currently, there is a negative correlation between leverage and P/E valuation.
- The stock market has discounted additional write-downs of property value via lower share prices.



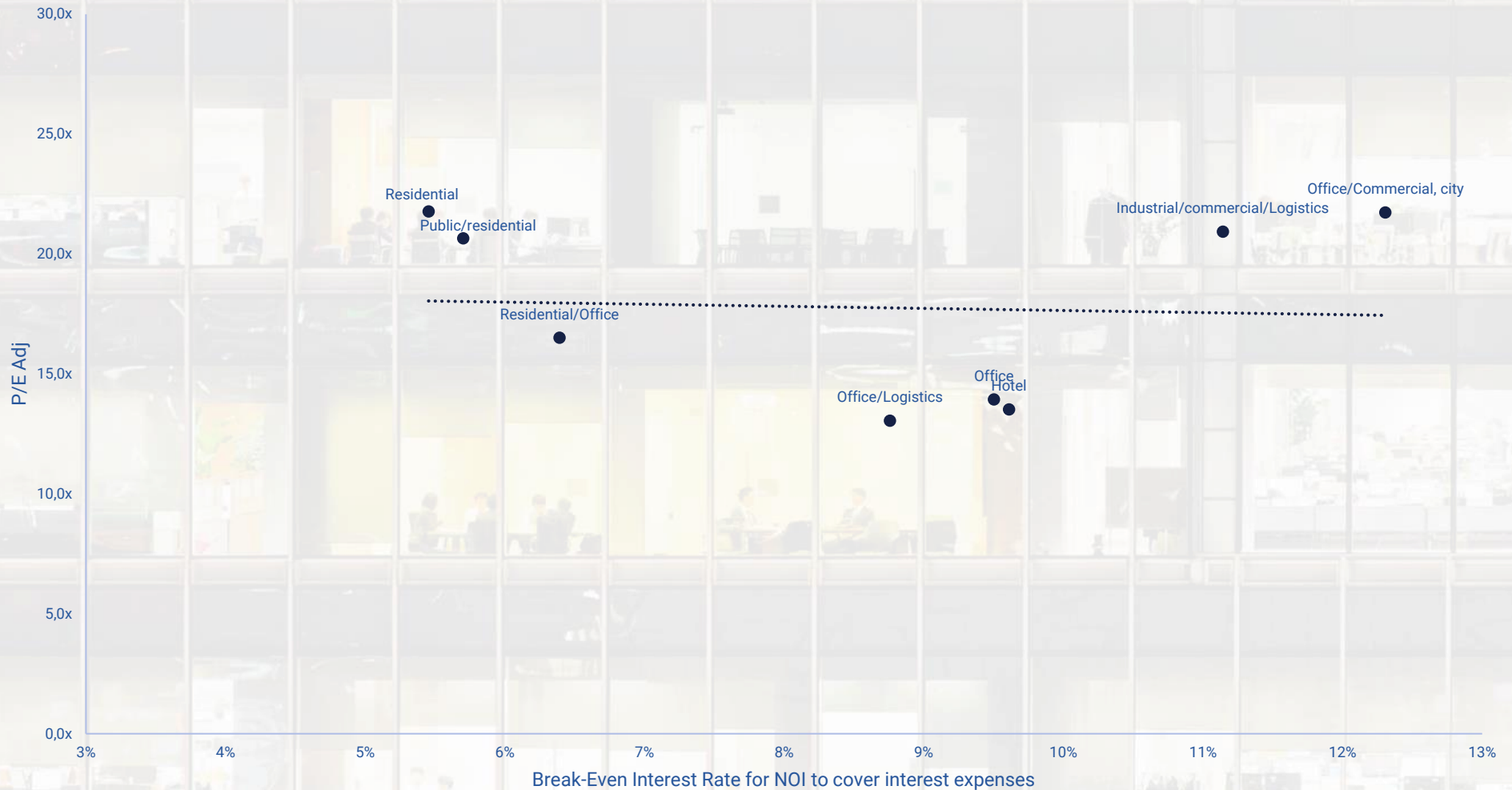
- SBB i Norden (relatively highly leveraged) dominates the Public/Residential sector, while low-leveraged Hufvudstaden is the largest in Office/Commercial/City.
- Residential Companies still trade at the highest P/E-multiples in the property sector, but the gap with other sectors has narrowed during 2022.
- Industrial and logistics properties offer the highest yields and can therefore bear the highest interest costs.



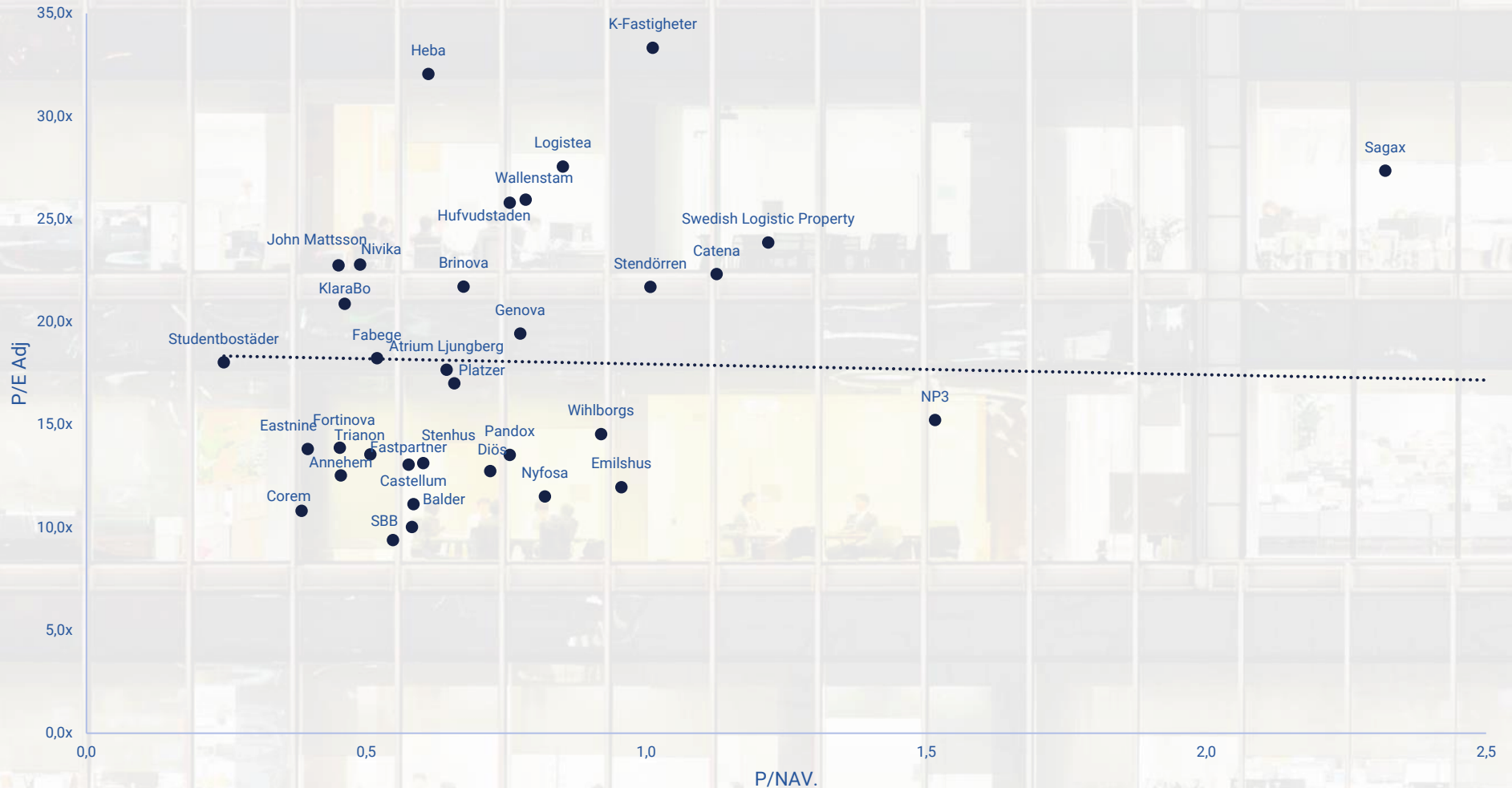
- Hufvudstaden has the lowest debt-to-equity in the sector.
- Residential companies such as John Mattsson and K-Fastigheter are most sensitive to interest changes.
- Most real estate companies can manage between 6 and 10% interest before cashflow becomes negative.



- Owner of Office/Logistic properties can manage interest rates of 12% before they turn cash-flow negative.
- Residential properties and mixed portfolio that includes residential property only manage 4 to 6% interest rate.
- Increased interest rates would lower valuation multiples (such as P/E-ratio) for the whole sector, but most significantly for Residential company stocks.



- Property shares are trading between 21% and 219% of their NAV.
- If Price/NAV and P/E are combined, companies with a high proportion of bonds are among the lowest valued.
- Residential companies are often valued both at a high P/E-ratio and at a significant discount to NAV.



- Companies with Industrial/Commercial/Logistic Properties trade at only some 10% discount to their NAV.
- Residential companies trade at the highest P/E ratio, but also at the largest discount to NAV.
- Investors see highest risk in office property, where stocks are trading at the lowest combined valuation.

