

Swedish Real Estate Outlook

Cautious optimism in the air

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Executive summary

Cautious optimism in the air

- Continued interest rate cuts in sight
- Reported average interest rates reaching peak levels
- Recession risk still prominent
- Already seen most of the reported property value declines
- Continued rise in the number of distressed credit events

Swedish real estate: Likely interest rate cuts allow for cautious optimism

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Financial ratios in Sweden's real estate sector look set to benefit from ongoing interest rate cuts that we expect to continue through 2025 towards normalised floating levels of about 2%. We also believe that some issuers in the sector could have seen their average interest rates peak. Our expectations follow a period in which the debt-laden sector has been buffeted by surging inflation and subsequent increases in policy rates by the central bank. Real estate companies now face some respite: inflation has decreased from a peak in December 2022 and the central bank responded with rate cuts totalling 50bps in May and August.

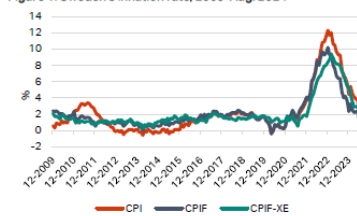
Capital market financing became increasingly accessible at longer tenors for property managers in the first half of the year, with substantial amounts of new issues at more normalised levels relative to the elevated capital market spreads of 2022 and 2023. We take a positive view of the reopening of the capital markets for the sector and the subsequent easing of refinancing concerns for most issuers.

We believe that the transaction market, which was sluggish throughout 2023 and the first half of 2024, will pick up in the remainder of the year as uncertainty over interest rates recedes and financing becomes more accessible at attractive levels. We also believe that we have already seen most of the likely value declines in the sector because financing costs are justifying book values in higher yielding subsectors. However, lower yielding subsectors such as residential properties could see further corrections due to continued misalignment of sellers' and buyers' price expectations. We believe that further corrections will be largely dependent on asset quality and current book yields. As the financing landscape normalises and transactions pick up, uncertainty about property values is likely to recede. We are cautiously optimistic about the implications of improved financing conditions for real estate managers. However, vacancies could increase in the sector as the economy weakens, with a negative impact on business risk profiles.

INTEREST RATE CUTS LIKELY TO CONTINUE

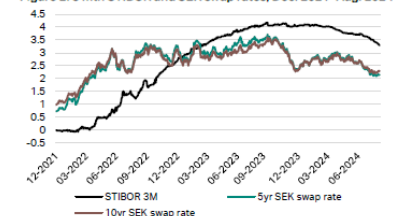
As inflationary pressure recedes, market interest rates on borrowing for long periods have fallen markedly. As of 30 Aug. 2024, the five-year swap rate stood at 2.1% compared with 3.5% a year earlier. In May 2024, the central bank lowered its key policy rate by 25bps, the first such cut in eight years. The rate was lowered by a further 25bps in August. In line with the market, we expect a continued fall in interest rates in the remainder of 2024 and 2025 towards a normalised floating rate of about 2%.

Figure 1. Sweden's inflation rate, 2009-Aug. 2024



Source: Statistics Sweden. CPI—consumer price index; CPIF—consumer price index with fixed interest rate; CPIF-XE—consumer price index with fixed interest rate—excluding energy.

Figure 2. 3 mth STIBOR and SEK swap rates, Dec. 2021–Aug. 2024



Source: Capital IQ.

Most real estate companies have secured portions of their financing costs with interest rate swaps or caps that have delayed and offset some of the impact of higher interest rates. As a result, the timing and impact of higher market rates will differ depending on the extent and duration of interest rate

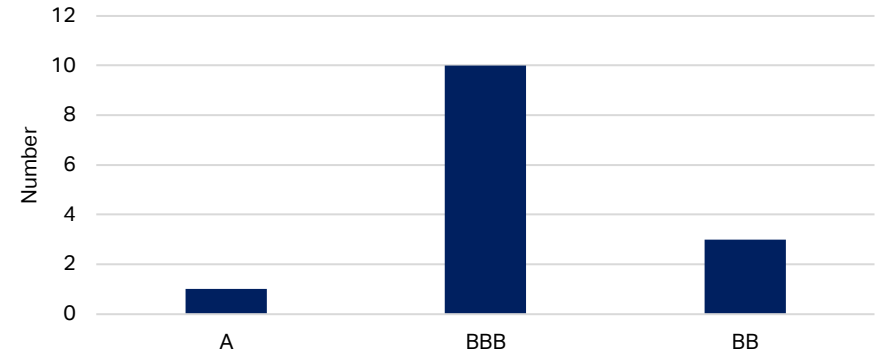
Nordic Credit Rating has wide real estate coverage

Overview of NCR's Swedish real estate coverage

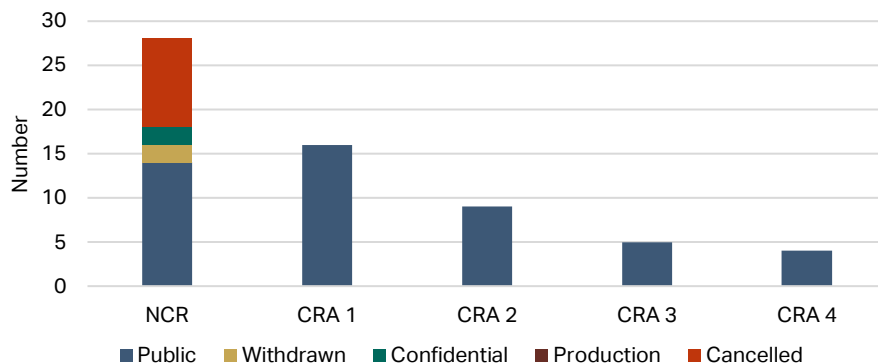
Broad real estate coverage

- Nordic Credit Rating covers 14 Swedish real estate issuers across different property segments
- Ratings range from 'A-' to 'BB-'
- Most issuers are currently on stable outlook, reflecting our expectations that business and financial performance will remain within our rating drivers

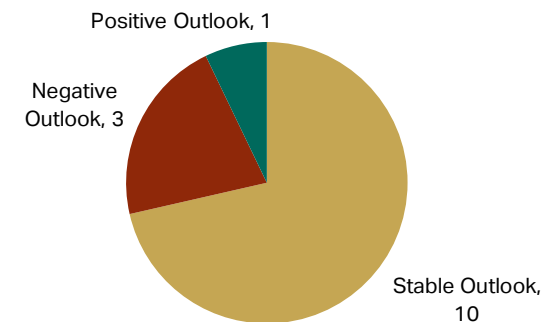
Rating distribution of NCR's Swedish real estate coverage



Number of Swedish real estate ratings



Outlook distribution

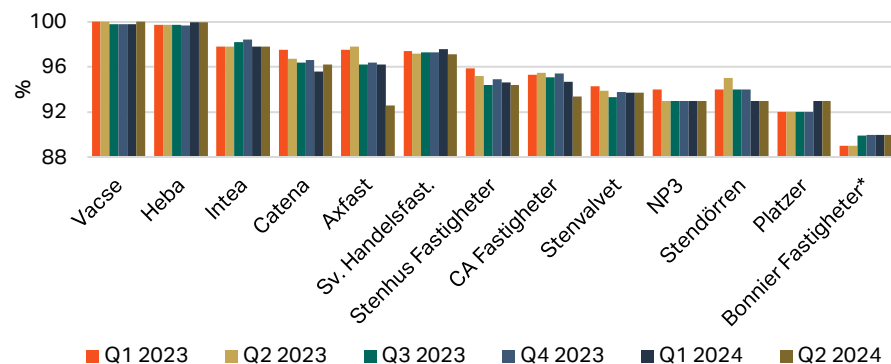


Limited impact on business risk profiles

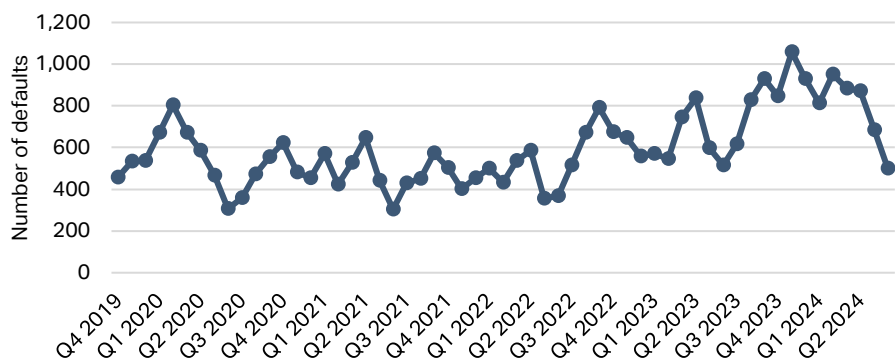
Solid business fundamentals

- Business fundamentals remain solid
- Weaker economy increases vacancy risk due to declining profitability
- Concerns related to occupancy and rent levels likely to loom over the sector
- Tenant strength and locational attractiveness are key for continued strong occupancy and cash flows

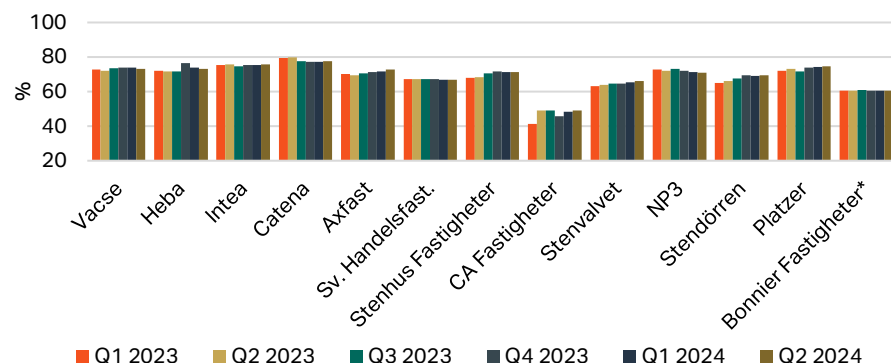
Occupancy rates



Company defaults in Sweden 2019– Aug. 2024



EBITDA margins

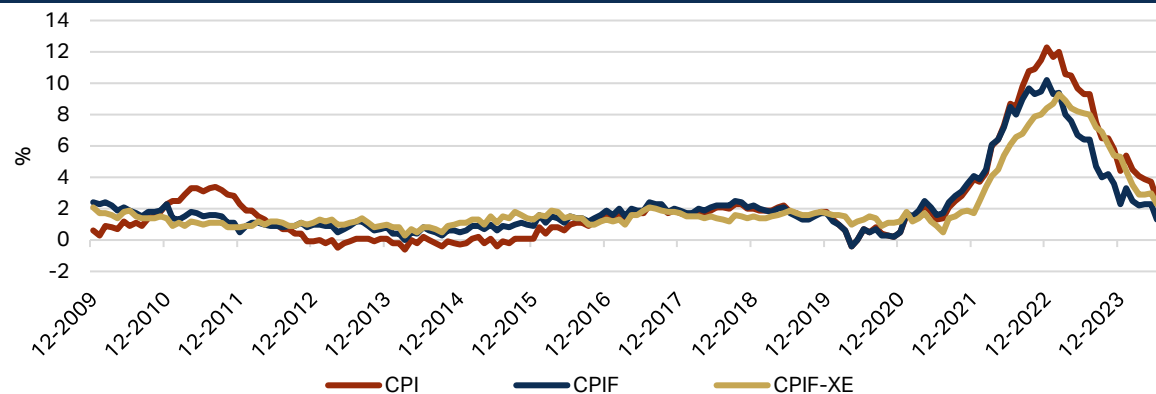


Continued interest rate cuts in sight

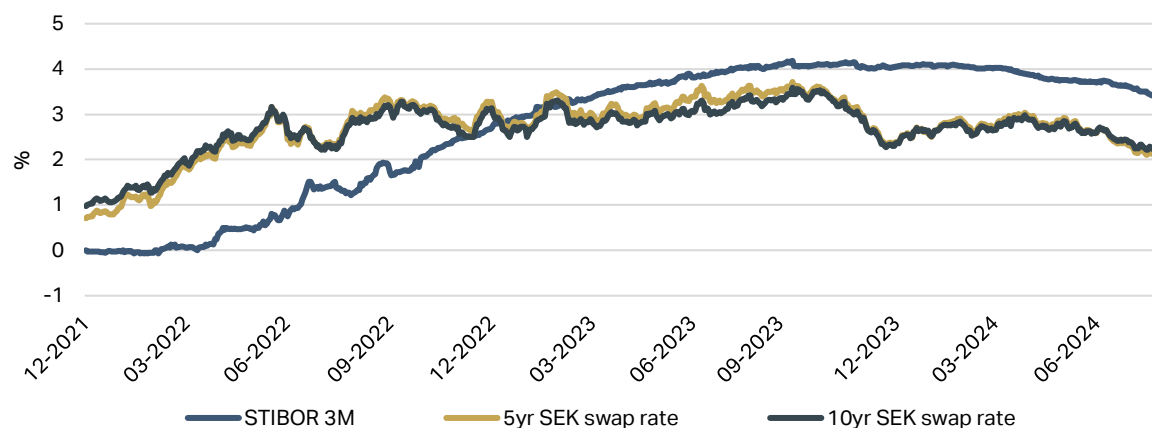
Further cuts expected

- Inflationary pressures recede due to weaknesses in the economy
- The Swedish central bank has initiated the cutting cycle
- Interest rates are likely to continue to fall in the remainder of 2024 and 2025
- We expect normalised floating interest rate of some 2%
- Rental growth and expected interest rate cuts could improve interest coverage ratio for some issuers

Sweden's inflation rate, 2009-Aug. 2024



3 mth STIBOR and SEK swap rates, Dec. 2021–Aug. 2024

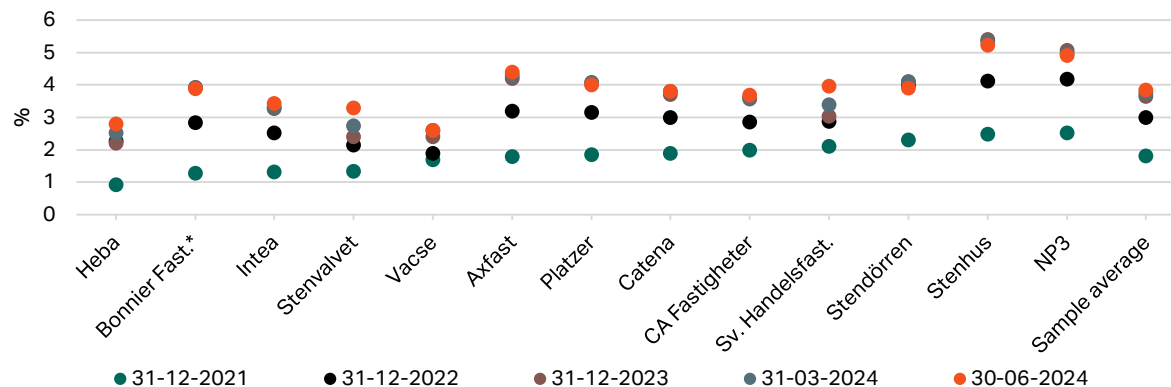


Reported average interest rates reaching its peaks

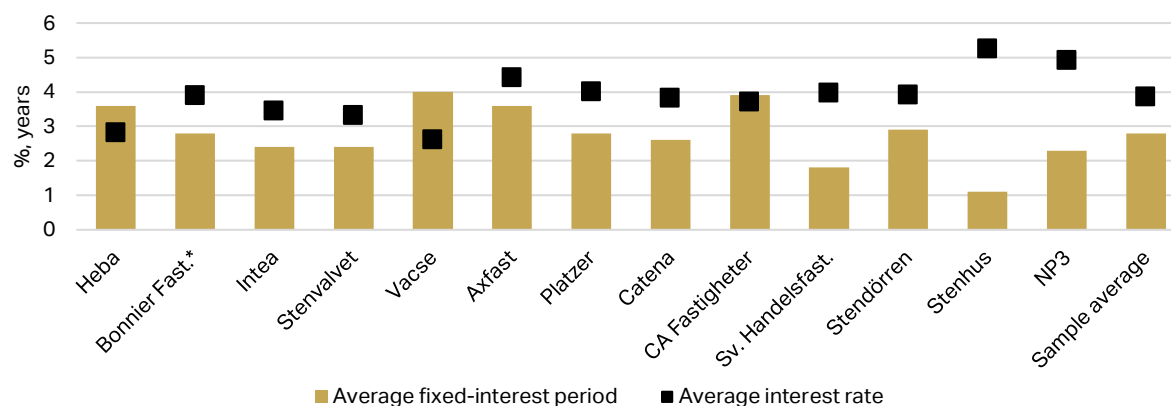
Interest rates

- Average interest rates have more than doubled for the sample since end-2021
- Investment grade issuers have experienced a larger relative increase in average interest rates than high yield issuers, despite entering the higher interest rate environment with longer fixed-interest periods
- Impact of higher rates will become more pronounced as old interest-swap contracts are replaced

Average interest rates have sharply risen across the sample since end-2021



Average fixed-interest period and average interest rates, 30 Jun. 2024

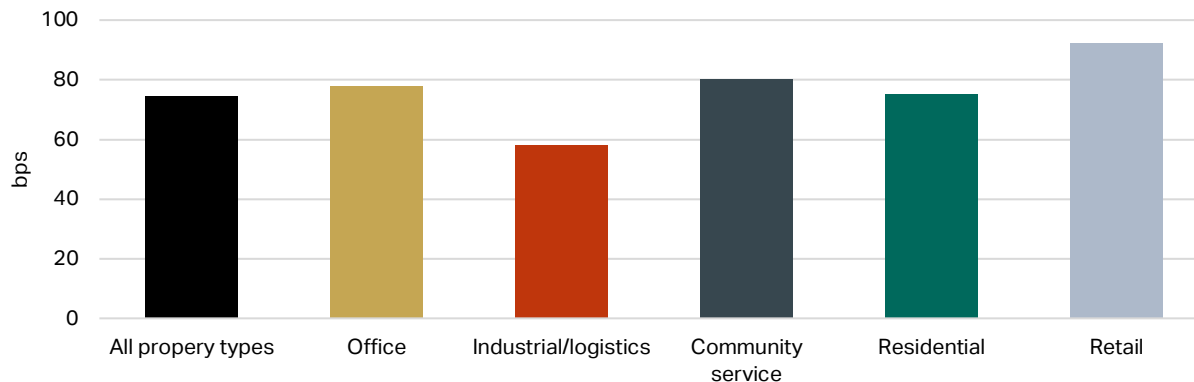


Already seen most of the value declines

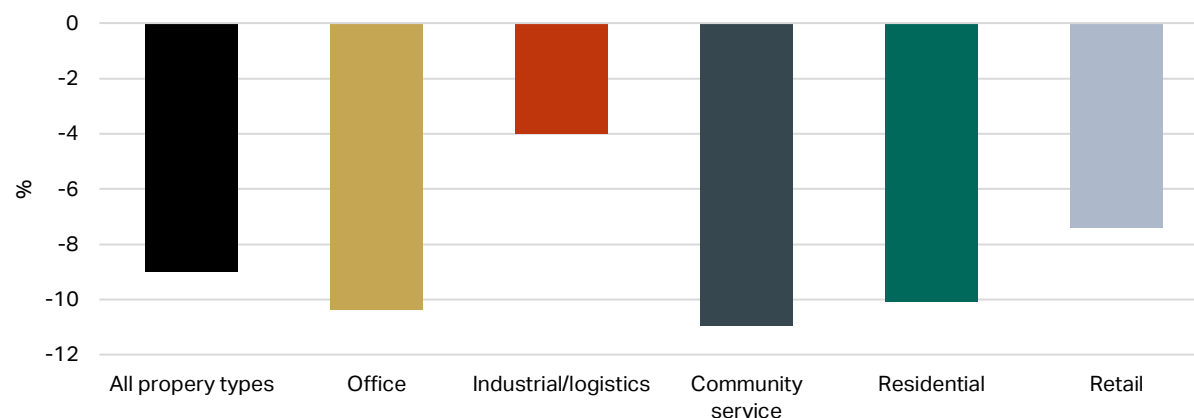
Property values are stabilising

- Yields have widened by about 75bps from 30 Sep. 2022 to 30 Jun. 2024
- CPI-linked rental leases has offset impact for most segments
- Decline in reported property values has averaged 9%
- Expect transaction activity to increase in the remainder of 2024 as interest rate risk recedes and price expectations between buyers and sellers increasingly align
- Property location and asset quality key determinant of price achievement and validation of book values for some issuers
- Yields are stabilising as access to capital improves

Property yields have widened by 75bps on average, 30 Sep. 2022-30 Jun. 2024



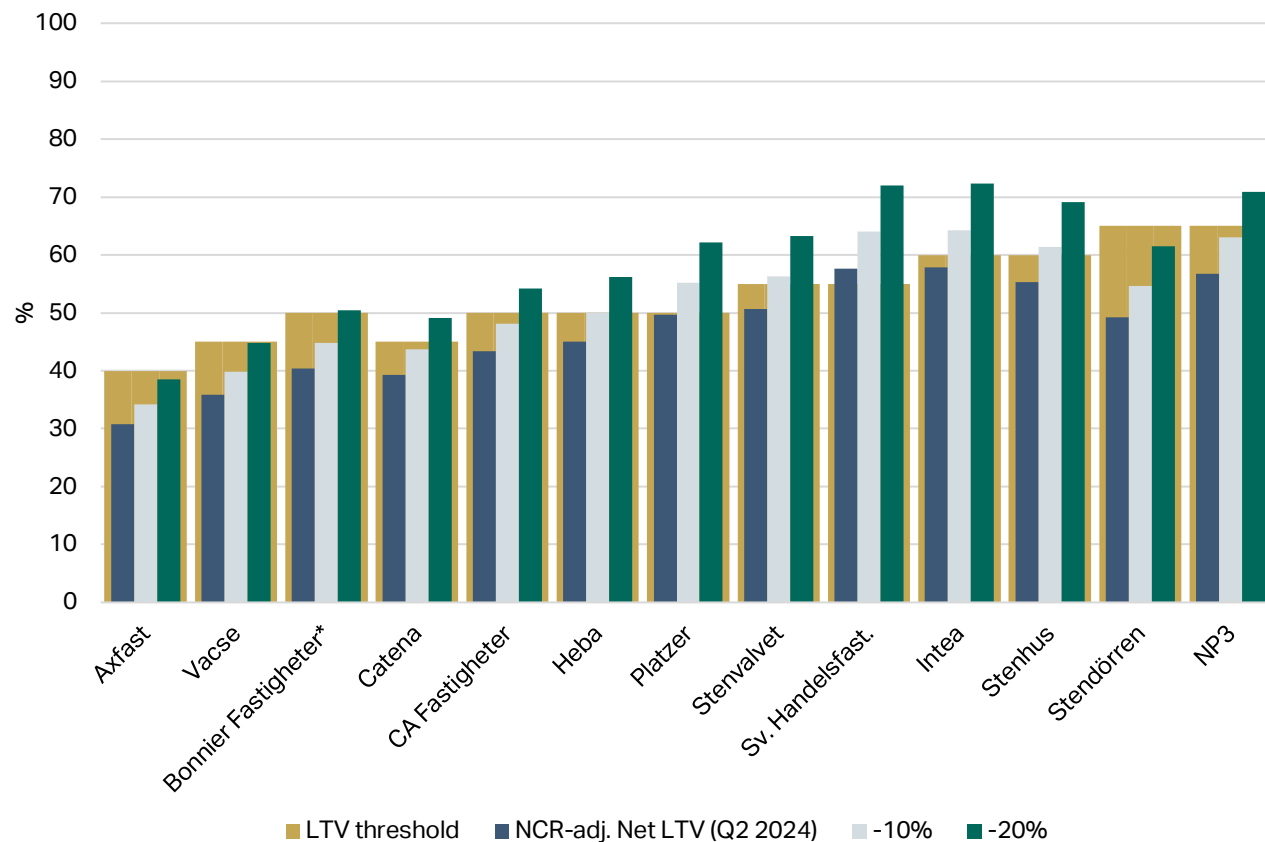
Property values have declined by 9% on average, 30 Sep. 2022-30 Jun. 2024



Headroom LTV ratios NCR-rated companies

Headroom to rating drivers remain adequate for most issuers

- More than half of NCR-rated real estate issuers could sustain a further 10% decline in property values without breaching their rating triggers
- Our expectations for further declines varies by segment, market and current yields
- We believe that we have already seen most of the valuation changes already because of adjusted yield requirements

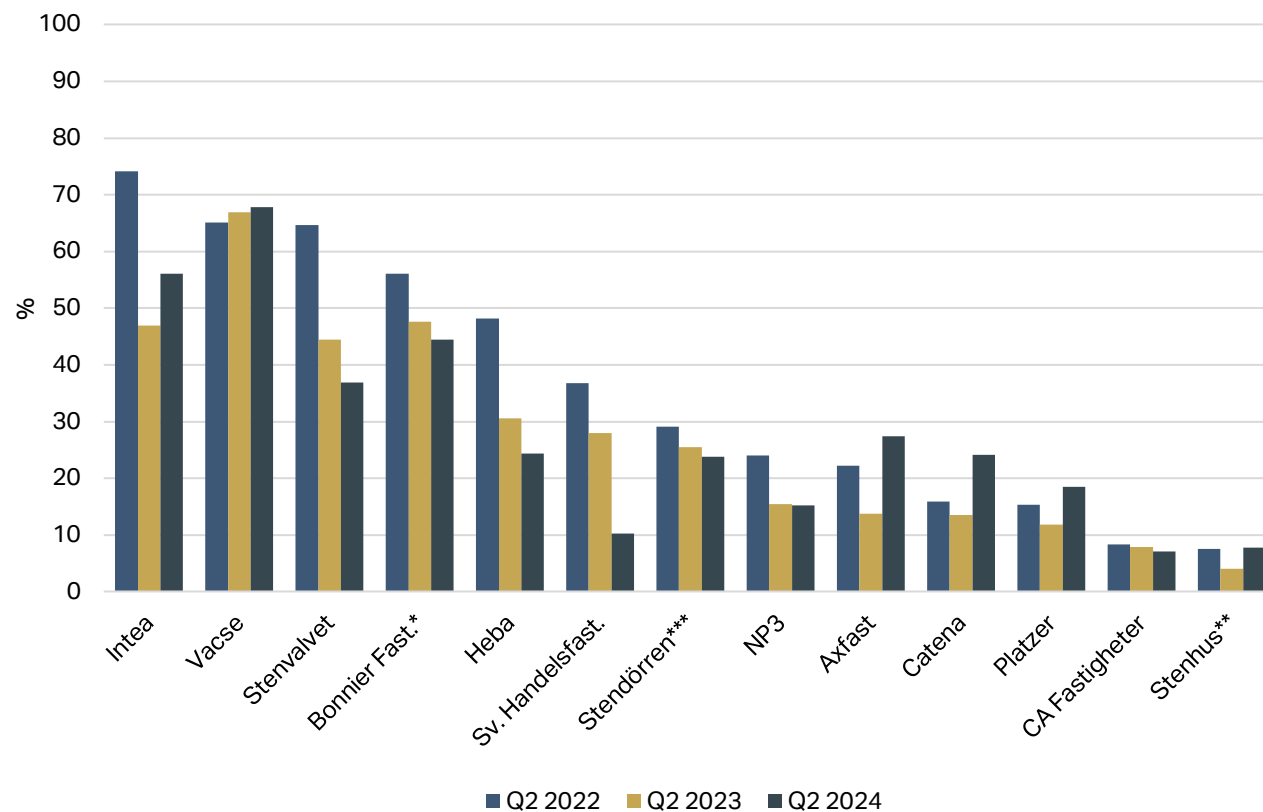


Capital market financing

Limited refinancing risk

- Capital market financing has increasingly been replaced with bank financing due to elevated spreads
- Capital market funding has declined by 9% of outstanding debt on average since Q2 2022
- Access to capital markets has improved through 2024
- Some issuers are likely to see a rebound in capital markets financing

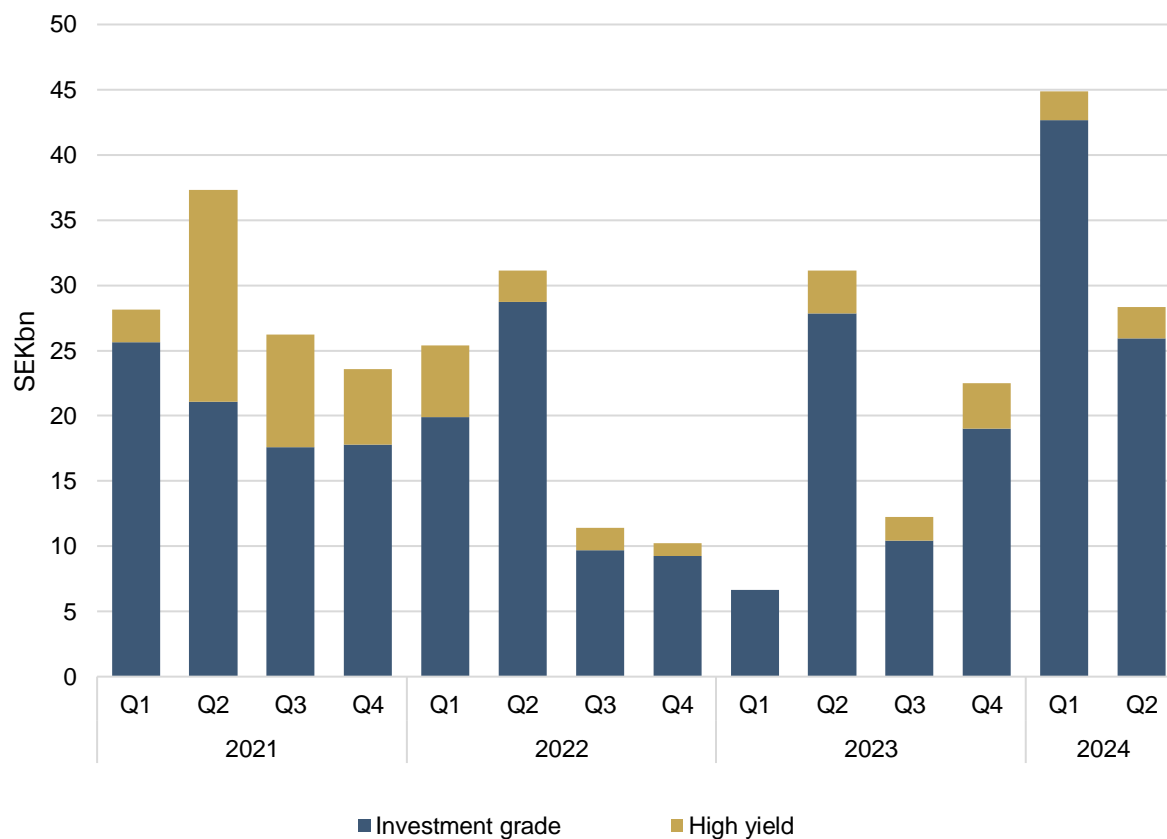
Capital market funding has declined



Real estate bond issues

Issued volumes in SEK for real estate issuers

- Issued volumes have been low since inflation and interest-rates surged in 2022 and 2023
- However, issued volumes has rebounded significantly through 2024
- For larger issuers, the euro market looks increasingly accessible as international investors' fears recede
- Refinancing in capital markets is available for most real estate issuers, including high yield

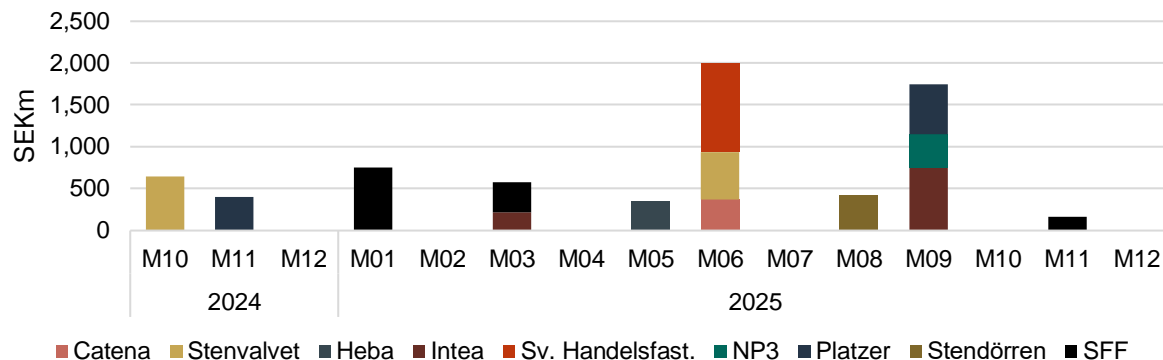


NCR-rated real estate bond maturities and issues

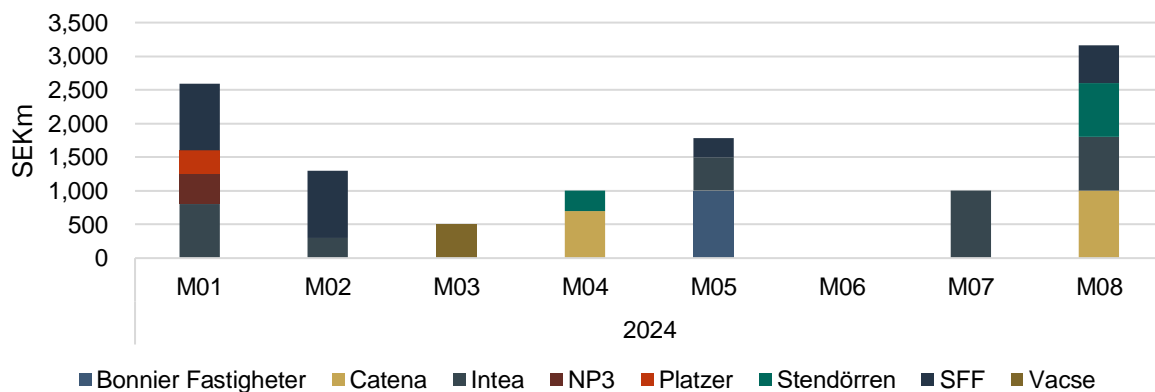
Lower refinancing risk

- NCR-rated issuers have relatively small amounts of capital markets debt maturing over the next 15 months
- A total of SEK 7bn in capital market maturities
- Small amounts of capital market debt maturing for each single issuer
- For investment grade issuers, these are typically covered by committed available credit facilities
- High yield issuers have been more proactive in dealing with refinancing risk
- Slightly higher amount of bonds issued in 2024
- Improved pricing has resulted in longer-dated bonds at lower spreads than 2022 and 2023

NCR-rated real estate bond maturities



NCR-rated real estate bond issues



Outlook

Looking ahead...

- Continued fall in interest rates for the remainder of 2024 and in 2025, approaching normalised floating rate of some 2%
- Capital market financing to become increasingly accessible at longer tenors for property managers
- Transaction market to pick up as interest rate uncertainty recedes
- Seen most of property value declines already
- Remain cautious as the economy weakens

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NCR public real estate ratings

Detailed public real estate ratings¹⁾

Issuer															
Long-term rating	A	A-	BBB	BBB	BBB	BBB	BBB	BBB-	BBB-	BBB-	BBB-	BBB-	BB	BB	BB-
Outlook	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Negative	Negative	Negative	Positive
Business risk assessment	bbb+	a-	bbb-	bbb	bbb+	a-	bbb+	bbb-	bbb-	bbb-	bb+	bbb-	bb+	bb+	bb+
Primary property type(s)	Public	Public	Office	Logistics	Residential	Public	Public	Office	Residential	Retail	Retail	Office	Industrial	Retail & Industrial	Logistics
Portfolio size (SEKbn)	25.6*	9.9	21.7	36.1	13.2	22.4	15.6	15.6	15.0	14.8	16.9*	28.5	21.0	13.9	12.9
Avg. remaining lease term (yrs)	5.6	9.3	5.4	5.8	-	6.4	5.1	3.2	5.3**	4.9	5.1	4.5	3.9	6.2	4.1
Financial risk assessment	bbb	bbb+	bbb+	bbb	bb+	bb+	bbb-	bbb-	bb+	bbb	bb+	bb+	b+	b+	b+
EBITDA/net interest (x)	2.4	4.7	2.8	4.0	3.2	2.5	3.3	2.2	2.7	3.6	2.1	2.1	2.0	1.8	1.6
Net debt/EBITDA(x)	11.2	8.2	9.9	9.5	14.7	15.3	11.8	11.5	12.0	9.3	13.3	12.1	8.9	10.7	10.5
Net LTV (%)	39.8	35.8	26.7	39.3	45.0	57.8	50.7	40.3	43.3	51.1	42.1	49.7	56.7	55.9	49.2

NCR public real estate ratings

Detailed public real estate ratings¹⁾

Issuer															
Long-term rating	A	A-	BBB	BBB	BBB	BBB	BBB	BBB-	BBB-	BBB-	BBB-	BBB-	BB	BB	BB-
Outlook	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Negative	Negative	Negative	Positive
Primary property type(s)	Public	Public	Office	Logistics	Residential	Public	Public	Office	Residential	Retail	Retail	Office	Industrial	Retail & Industrial	Logistics
Portfolio size (SEKbn)	25,6*	9.9	21.7	36.1	13.2	22.4	15.9	15.6	15.0	14.8	16.9*	28.5	21.0	13.9	12.9
Ownership	Gov't (Bane NOR SF)	Pension funds	Private (Ax:son Johnson family)	Listed	Listed	Pension funds	Pension funds	Private (Bonnier family)	Private (Claesson family)	Pension funds	Member association (OBOS BBL)	Listed	Listed	Listed	Listed