

Swedish Real Estate Outlook

Swedish real estate sector adapts to
tougher financing climate

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Gustav Nilsson

Analyst

Yun Zhou

Analyst



Executive summary

Uncertainties recede, but downside risk remains

- Interest coverage ratios set to improve due to expected interest rate cuts in 2024
- Increased vacancy risk in more cyclical segments, with potential implications for rent levels
- Long-term financing cost do not justify current valuations in lower yielding segments
- Limited refinancing risk for most issuers, but tougher financing conditions likely to persist
- A rise in distressed credit events, written procedures and restructuring

Swedish Real Estate Sector Adapts to Tougher Financing Climate

ANALYSTS
Gustav Nilsson
+46735420446
gustav.nilsson@nordiccreditrating.com
Yun Zhou
+46732324378
yun.zhou@nordiccreditrating.com

The surge in inflation over the past two years and the subsequent interest rate hikes by Sweden's central bank have led to concerns about the debt-laden Swedish real-estate sector. Interest coverage has weakened across the sector as financing costs have risen sharply on the back of markedly higher spreads and variable rates on borrowing since early 2022. However, it appears we have reached the peak of central bank rate hikes as inflationary pressures recede and the economic outlook remains gloomy, which are widely expected to result in interest rate cuts in 2024. Depending on the timeliness and extent of potential policy rate cuts over the next few years, some issuers' average interest rates may peak in 2024 and their interest coverage ratios look set to improve.

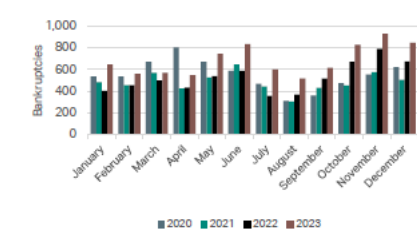
Reported property values in Sweden have been remarkably resilient so far, with only moderate value declines despite higher yields. However, transaction activity has remained relatively low, delaying inevitable property value revisions as long-term financing costs remain prohibitive for a large proportion of potential buyers. We expect more transactions to be completed in 2024 as buyers and sellers' price expectations become increasingly aligned, assisted by lower long-term borrowing rates, which we believe will accelerate declines in reported property values and add pressure to loan-to-value ratios.

We downgraded multiple issuers in 2023, as we believe that their capital structures will remain weaker than previously expected over a prolonged period. We currently have four companies on negative outlook, indicating that some issuers face an increased risk of downgrade in 2024. However, we also have one company, Catena, on positive outlook, as a result of two equity injections and more conservative leverage targets. Many companies that we rate have strong owners capable of injecting equity if necessary, while others have maintained adequate policy and rating headroom.

OCCUPANCY RATES TO BE AFFECTED IN MORE CYCLICAL SEGMENTS

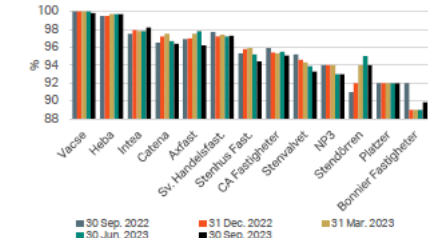
Thus far, the challenges in the real-estate sector have largely been isolated to financing rather than operational performance, and business fundamentals such as rental values and occupancy rates have remained solid. However, vacancy risks are mounting in Sweden, as the economy is weakening and default rates among Swedish corporations hit record levels in 2023. Construction, retail and hospitality have been the most affected sectors, but higher production costs and reduced consumer spending are likely to lead to more sectors struggling.

Figure 1. Company bankruptcies in Sweden 2020–2023



Source: CreditSafe.

Figure 2. Occupancy rates of NCR-rated Swedish real-estate issuers, 30 Sep. 2022–30 Sep. 2023



Source: companies, Bonnier Fastigheter reports on a partial basis.

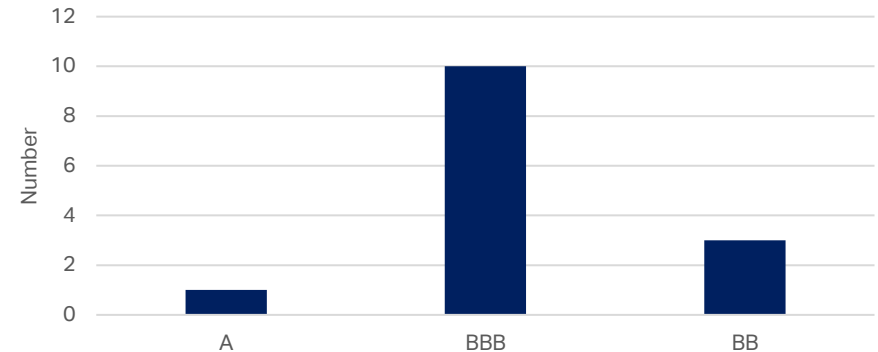
Nordic Credit Rating has wide real estate coverage

Overview of NCR's Swedish real estate coverage

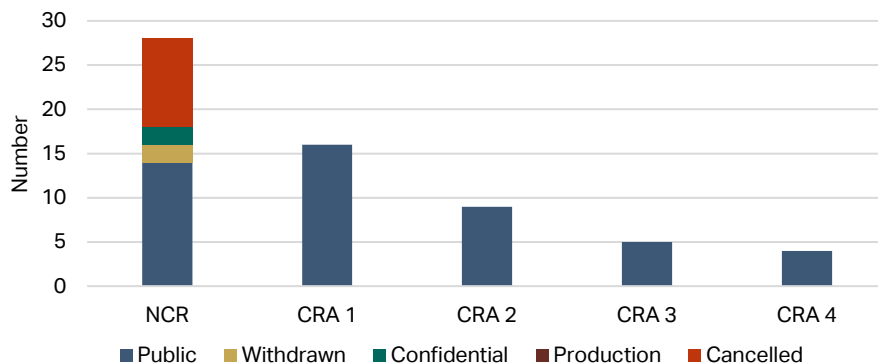
Broad real estate coverage

- 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

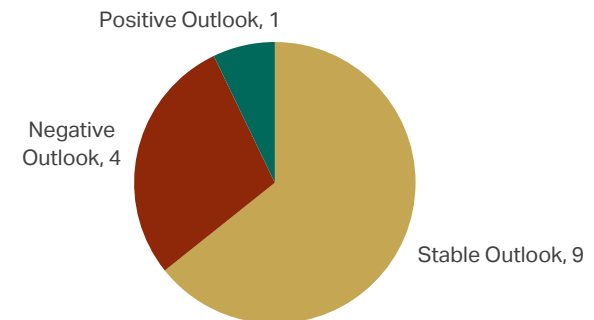
Rating distribution of NCR's Swedish real estate coverage



Number of Swedish real estate ratings



Outlook distribution



Underlying business remains strong

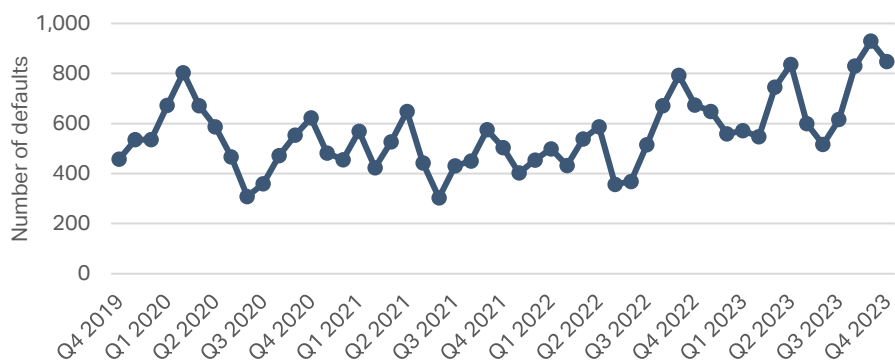
Solid business fundamentals, for now

- Business fundamentals remain solid and it is still possible to increase rental levels for new leases in some segments
- Weaker economy increases vacancy risk due to declining profitability in more sectors, with potential implications for future rent levels
- Tenant strength and locational attractiveness are key determinants of continued strong occupancy and cash flows

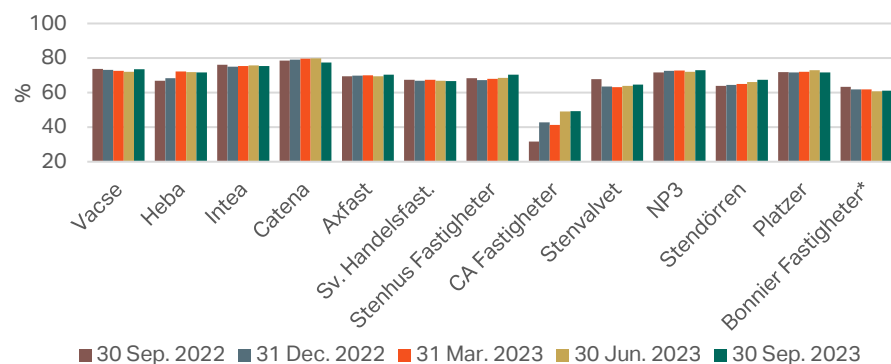
Occupancies rates have been relatively flat



Company defaults in Sweden 2019–2023



EBITDA * margins have barely moved for most issuers

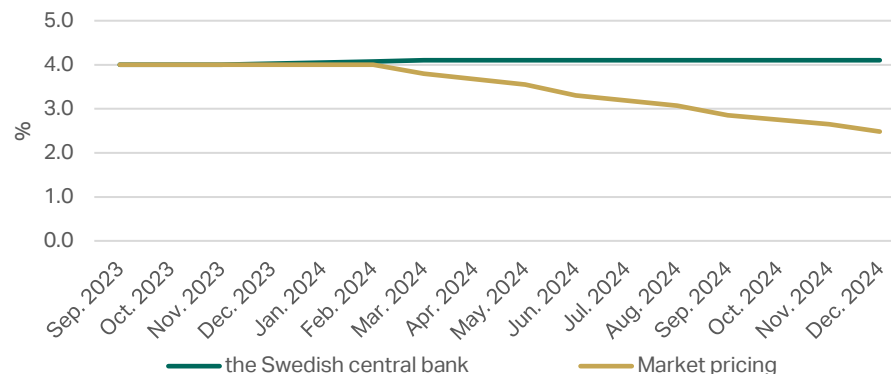


Interest coverage could improve in 2024

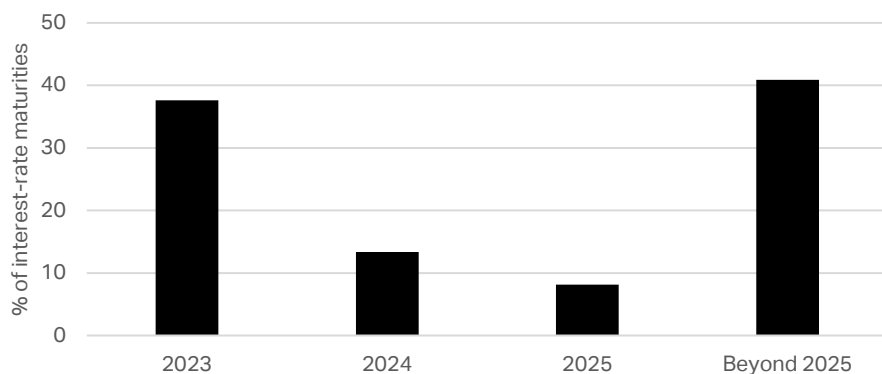
Sharp declines in market interest rates to be expected

- Market expects the Swedish central bank to cut interest rates by 150bps
- Swap contracts are priced below floating rates, possibilities to swap for better interest coverage ratios
- Lower swap rates provides an opportunity to reduce interest rate risk
- Some issuers may see their average interest-rates nearing their peak

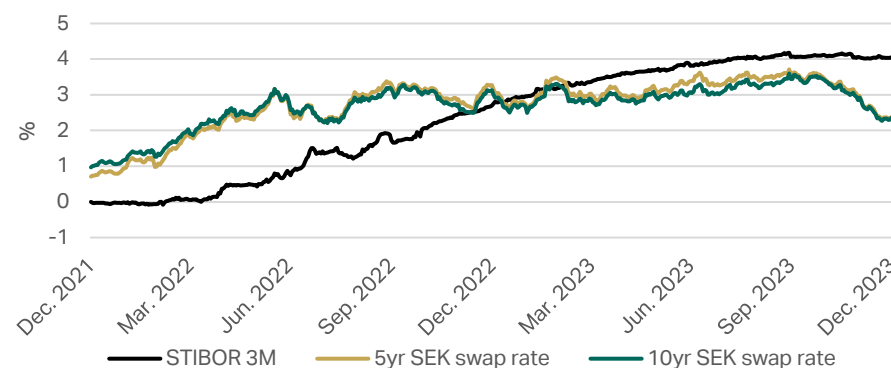
Interest rate expectations, 2024e



Limited aggregated swap volumes expiring in 2024



Sharp decline in swap rates in the fourth quarter of 2023

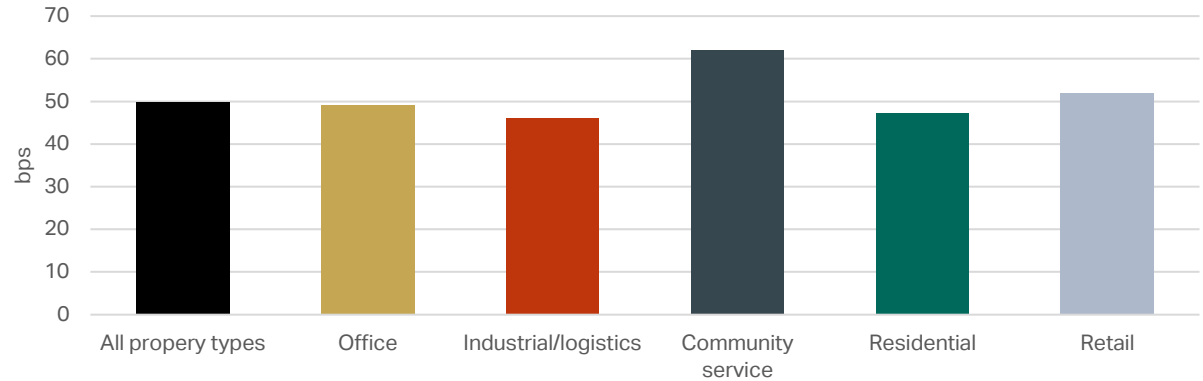


Uncertainty around property values remains

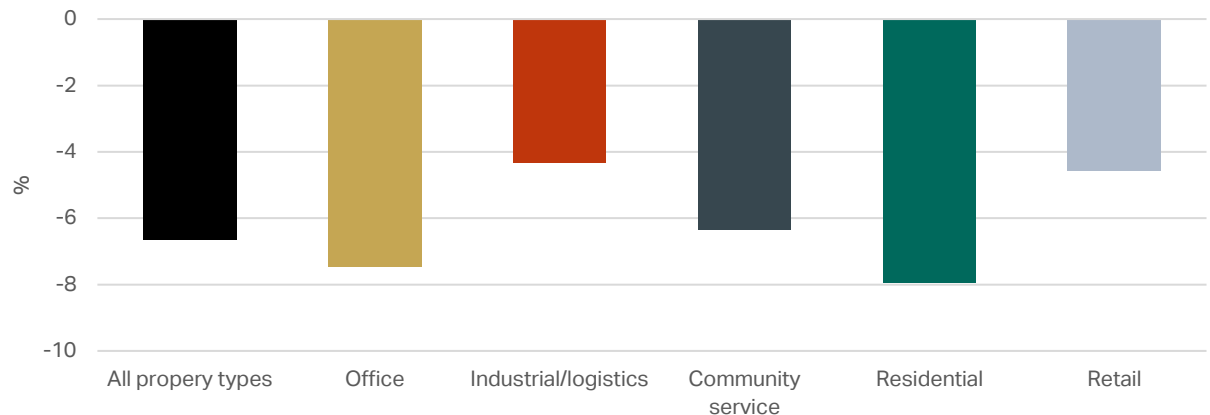
Property values set to decline

- Yields have widened by about 50bps from 30 Sep. 2022 to 30 Sep. 2023
 - CPI-linked rental leases offset impact for most segments
- Expect transaction activity to increase in 2024 as the risk of higher interest rates recede, with increased alignment of price expectations between buyers and sellers
- Commercial property yields could see a top-to-bottom yield adjustment of between 100–125bps
- Differences between prime yields and secondary yields set to widen due to higher vacancy risk and flight to quality

Property yields have widened by 50bps on average, 30 Sep. 2022-30 Sep. 2023



Property values have declined by 7% on average, 30 Sep. 2022-30 Sep. 2023



Financing costs imply further widening yields

Yields are set to widen

- Higher proportion of equity financing necessary to maintain an investment grade interest coverage ratio and have reasonable covenant headroom
- Financing costs are prohibitive for buyers which cannot use full-equity financing in lower yielding segments
- Limited number of transactions have materialised in the residential segment
- Grocery and discount retailing along with industrials have yields that support debt-financed transactions

Portfolio yield required for an interest coverage ratio above 2.2x

		Gross loan to value, %										
		20	25	30	35	40	45	50	55	60	65	70
Average interest rate, %	1.00	0.4	0.6	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.4	1.5
	1.25	0.6	0.7	0.8	1.0	1.1	1.2	1.4	1.5	1.7	1.8	1.9
	1.50	0.7	0.8	1.0	1.2	1.3	1.5	1.7	1.8	2.0	2.1	2.3
	1.75	0.8	1.0	1.2	1.3	1.5	1.7	1.9	2.1	2.3	2.5	2.7
	2.00	0.9	1.1	1.3	1.5	1.8	2.0	2.2	2.4	2.6	2.9	3.1
	2.25	1.0	1.2	1.5	1.7	2.0	2.2	2.5	2.7	3.0	3.2	3.5
	2.50	1.1	1.4	1.7	1.9	2.2	2.5	2.8	3.0	3.3	3.6	3.9
	2.75	1.2	1.5	1.8	2.1	2.4	2.7	3.0	3.3	3.6	3.9	4.2
	3.00	1.3	1.7	2.0	2.3	2.6	3.0	3.3	3.6	4.0	4.3	4.6
	3.25	1.4	1.8	2.1	2.5	2.9	3.2	3.6	3.9	4.3	4.6	5.0
	3.50	1.5	1.9	2.3	2.7	3.1	3.5	3.9	4.2	4.6	5.0	5.4
	3.75	1.7	2.1	2.5	2.9	3.3	3.7	4.1	4.5	5.0	5.4	5.8
	4.00	1.8	2.2	2.6	3.1	3.5	4.0	4.4	4.8	5.3	5.7	6.2
	4.25	1.9	2.3	2.8	3.3	3.7	4.2	4.7	5.1	5.6	6.1	6.5
	4.50	2.0	2.5	3.0	3.5	4.0	4.5	5.0	5.4	5.9	6.4	6.9
	4.75	2.1	2.6	3.1	3.7	4.2	4.7	5.2	5.7	6.3	6.8	7.3
	5.00	2.2	2.8	3.3	3.9	4.4	5.0	5.5	6.1	6.6	7.2	7.7
5.25	2.3	2.9	3.5	4.0	4.6	5.2	5.8	6.4	6.9	7.5	8.1	
5.50	2.4	3.0	3.6	4.2	4.8	5.4	6.1	6.7	7.3	7.9	8.5	
5.75	2.5	3.2	3.8	4.4	5.1	5.7	6.3	7.0	7.6	8.2	8.9	
6.00	2.6	3.3	4.0	4.6	5.3	5.9	6.6	7.3	7.9	8.6	9.2	
6.25	2.8	3.4	4.1	4.8	5.5	6.2	6.9	7.6	8.3	8.9	9.6	
6.50	2.9	3.6	4.3	5.0	5.7	6.4	7.2	7.9	8.6	9.3	10.0	

Residential

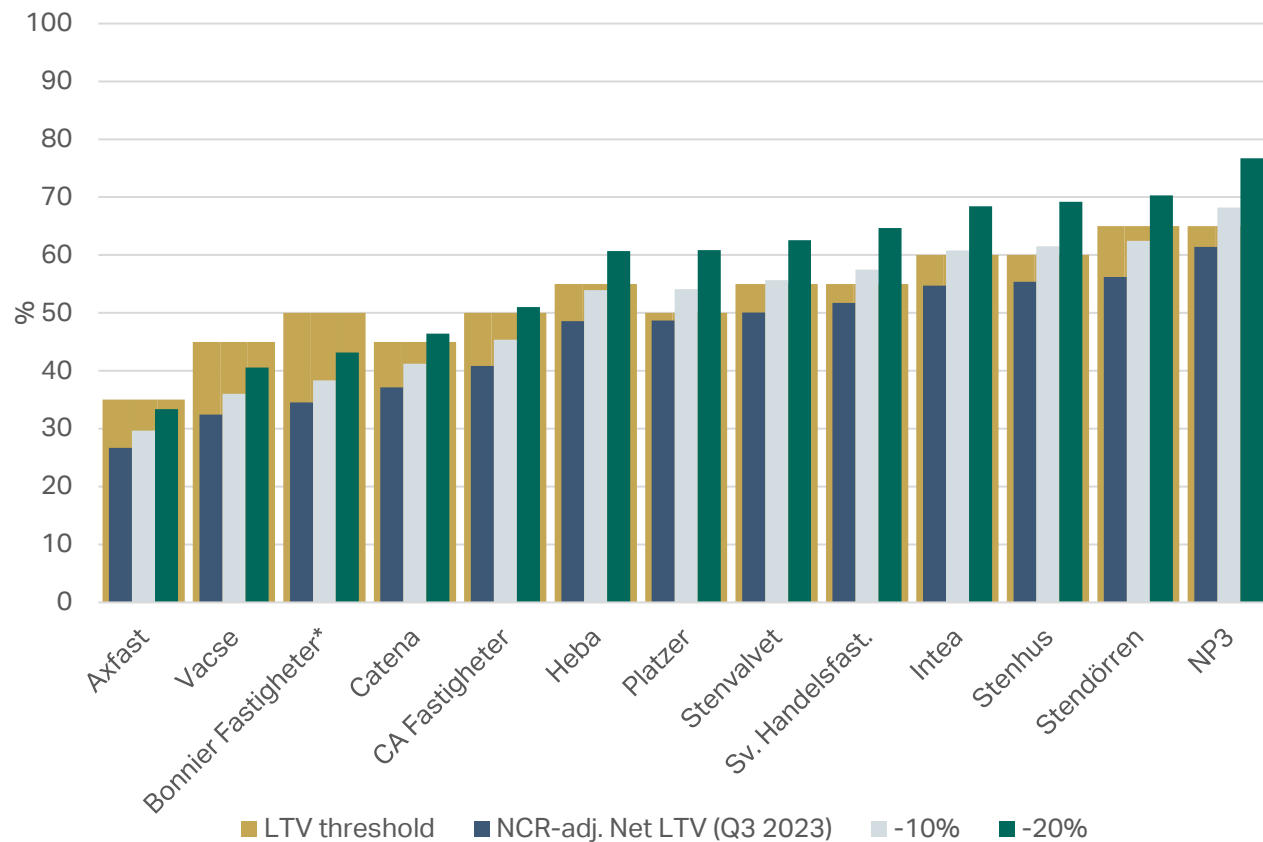
Industrial/logistics/retail

Community service

Headroom LTV ratios NCR-rated companies

Headroom to rating drivers remain adequate for most issuers

- 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

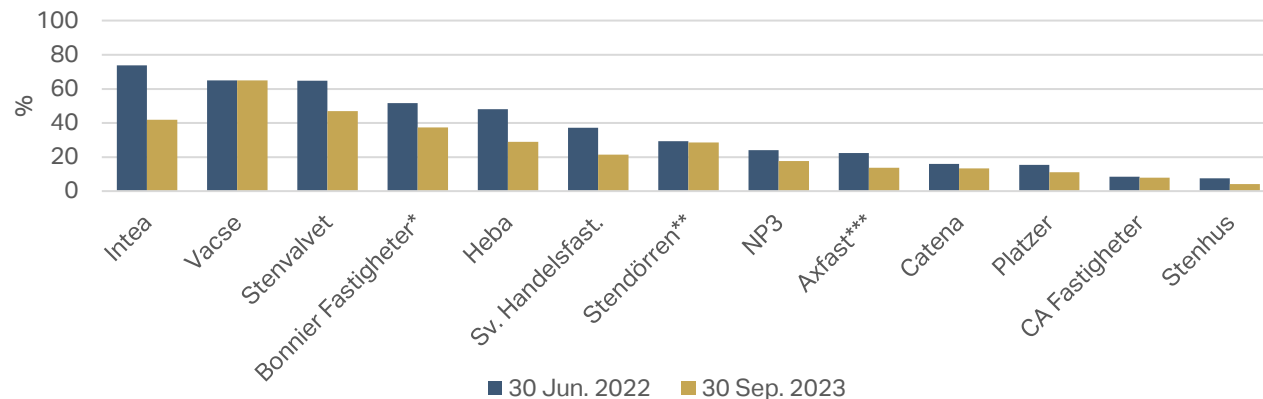


Capital market financing set to increase in 2024

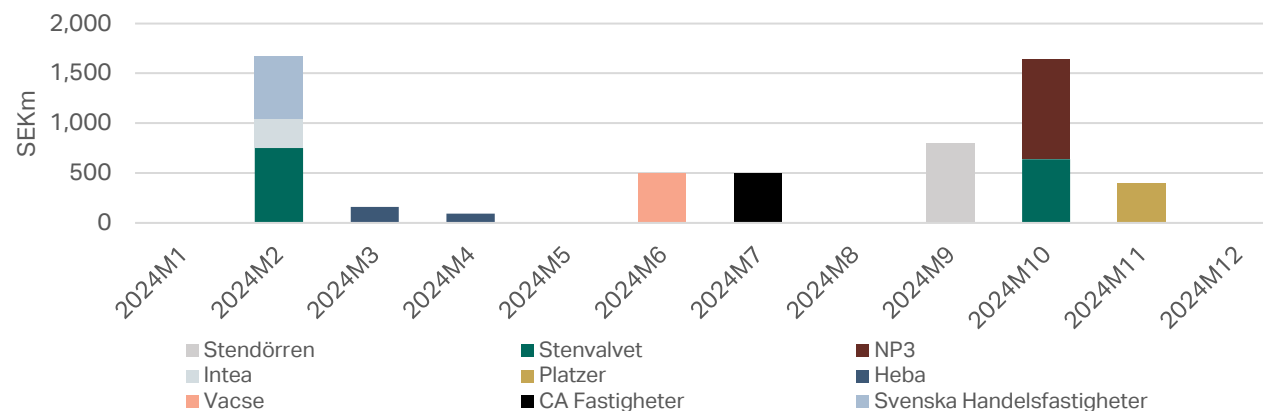
Limited refinancing risk in 2024

- Capital market financing has increasingly been replaced with bank financing due to elevated spreads
- However, bank financing is likely to contain new terms and conditions
- We expect capital market spreads to tighten relative to bank financing as uncertainty about financing costs recede, driving increased bond issuance in 2024
- Low volumes of bond maturities in 2024 can mostly be met through existing financing arrangements

Capital market funding has declined by 8% of outstanding debt since 30 Jun. 2022



NCR-rated issuers face limited bond maturities in 2024



Outlook

We expect...

- Market interest rates to decline as inflationary pressure recedes
- A peak in issuers' average interest rates, with forward-looking interest coverage ratios improving for some issuers
- Further declines in property values as financing costs remain prohibitive at current yield levels in some segments
- Elevated downside risk to occupancy and rent levels for cyclical segments
- Refinancing risk for most issuers is limited, but bank financing likely to have new contingencies

Nordic Credit Rating real estate contacts



Gustav Liedgren

Chief Executive Officer

gustav.liedgren@nordiccreditrating.com

+46 736 496 543



Gustav Nilsson

Credit Rating Analyst

gustav.nilsson@nordiccreditrating.com

+46 735 420 446



Sean Cotten

Chief Rating Officer

sean.cotten@nordiccreditrating.com

+46 735 600 337



Yun Zhou

Credit Rating Analyst

yun.zhou@nordiccreditrating.com

+46 732 324 378



Ylva Forsberg

Credit Rating Analyst

ylva.forsberg@nordiccreditrating.com

+46 768 806 742

NCR public Swedish real estate ratings

Detailed public Swedish real estate ratings¹⁾

Issuer	Vacse	Axfast	Stenvalvet	Intea	Heba	Catena	Bonnier Fastigheter	CA Fastigheter	Svenska Handelsfastigheter	Platzer	NP3	Stenhus Fastigheter	Stendörren
Long-term rating	A-	BBB	BBB	BBB	BBB	BBB-	BBB-	BBB-	BBB-	BBB-	BB	BB	BB-
Outlook	Stable	Stable	Stable	Stable	Negative	Positive	Stable	Stable	Stable	Negative	Negative	Negative	Stable
Business risk assessment	a-	bbb-	bbb+	a-	bbb+	bbb	bbb-	bbb-	bbb-	bbb-	bb+	bb+	bb+
Primary property type(s)	Public	Office	Public	Public	Residential	Logistics	Office	Residential	Retail	Office	Industrial	Retail & Industrial	Logistics
Portfolio size (SEKbn)	9.2	21.7	16.0	21.7	14.5	29.5	16.5	15.9	14.8	28.4	20.1	13.2	12.8
Financial risk assessment	bbb+	bbb+	bbb-	bb+	bb+	bbb-	bbb-	bb+	bbb-	bb+	b+	b+	b+
EBITDA/ net interest (x)	4.8	2.8	3.6	3.0	2.4	4.3	2.6	3.0	3.4	2.3	2.1	2.0	1.7
Net debt/ EBITDA(x)	7.6	9.9	12.2	15.4	17.1	8.1	11.3	13.4	9.8	14.0	9.7	10.5	12.7
Net LTV (%)	32.4	26.7	50.1	54.7	48.6	37.1	34.5	40.8	51.7	48.7	61.4	55.4	56.2
Ownership	Pension funds	Private (Ax:son Johnson family)	Pension funds	Pension funds	Listed	Listed	Private (Bonnier family)	Private (Claesson family)	Pension funds	Listed	Listed	Listed	Listed