Sector update, 19 April, 2022 10:37 CET

Real Estate

Brace for impact

- Headwinds from higher rates not fully reflected in valuations
- Inflation does not mean a safe haven for real estate companies
- We downgrade eleven stocks on poor near-term sentiment

Funding costs definitely on the rise

The Nordic real estate sector has short maturities on both rates (38% maturities within 12 months) and debt (72% maturing within four years), pointing at gradually increasing funding costs from increasing swap rates and bond spreads. After many years of hefty earnings growth, we should now expect something different. Property values are at risk, with a strong correlation between paid interest rate and yield requirements, and we believe that we could see the start of a new era in H2 2022. Given an average sector LTV of 52%, changes to NRV and earnings growth may be large. For H1 2022, we expect stable property values, owing to lag effects and low transaction volumes in the market. Interest rate and debt hedging also smooth the impact on cash earnings from higher rates, but the difference between companies is large.

No obvious support from inflation, in our view

In essence, property assets are CPI hedges, given the compensation on rental income. However, if nominal rates are increasing due to inflation, this will raise the cost of funding for real estate. A lift from 1.4% to 3.5% in the paid interest rate would reduce IFPM by >30% at 50% LTV. We see a risk that this headwind from higher rates, with a gradual impact on results, will come at the same time as deteriorating sentiment for acquisition-driven growth, the most powerful growth component over recent years. On top of this, construction seems to be much more costly for the foreseeable future, putting pressure on value and earnings growth from new developments. The cocktail of growth-hampering effects does not play very well with the current valuations in the market, and hence we now take the opportunity to downgrade several stocks in our covered universe.

Downgrading eleven shares on a bad cocktail for real estate

Higher funding costs, costly new constructions an increased risk of a recession/stagflation and relatively high share valuations all prompt us to take a particularly cautious stance in the near term. Our recommendation changes mean that we find no shares with near-term (three months) upside potential and we downgrade Balder, Heba, John Mattson, NP3, Platzer, Trianon and Wihlborgs to SELL (Hold) and Catena, Castellum, Stendörren and Pandox to HOLD (Buy). In a longer-term perspective, we downgrade Catena, Platzer and Stendörren to Market perform (Outperform) and Heba to Underperform (Market perform). We still see relevant upside in Fabege, while much of the three-year potential is affected by the near-term headwinds, meaning limited scope for market outperformance at this point.

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For full disclaimer and definitions, please refer to the end of this report.

Investment case and recommendation changes

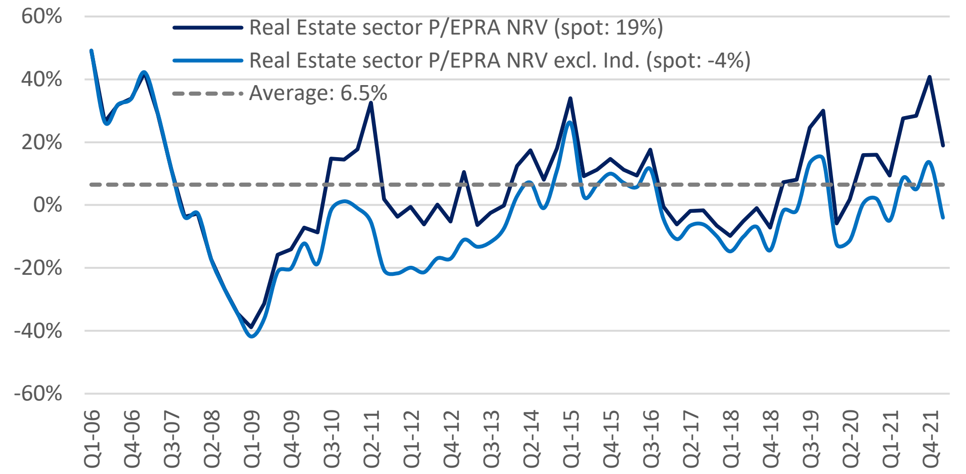
Following meaningful estimate changes (see next section), owing to higher funding costs, we downgrade eleven stocks within our short-term recommendation structure (three-month outlook). Besides the higher cost profile for borrowed capital, and the impact on cash earnings, we also highlight a meaningful risk of lower property values, as a result of higher funding costs in transactions. Lower property values are not captured in our estimates at this point and should be seen as an additional risk to share and earnings profiles over time. We argue that the muted growth profile, in general and more specifically as a consequence of higher rates, combined with the material risk of lower property values, is not captured in the valuation profile of the sector. As such, we see meaningful downside to shares on our three-month horizon. In a longer-term perspective (three years), we maintain a rather neutral stance. However, the expected near-term headwinds will have an impact on our long-term view, and we find no real good arguments for outperformance in general. The relative winners (>30% upside) within the sector and our covered universe, besides Fabege with an Outperform recommendation, are Atrium Ljungberg, Castellum, Catena, Entra, KlaraBo, Platzer, Stendörren, Wallenstam, and on average we see 29% share price potential over three years.

Our general take

We downgrade our near-term recommendations on a broad basis

We downgrade our near-term recommendations on a broad basis, due to the potential effects of higher rates, described in more detail later in this report. We see different risk profiles in the various names, based on differences in capital structure (share of market funding, for example), debt leverage (LTV), interest rate and debt maturity profiles, property yields and headroom for the interest coverage ratio (ICR). In general, we see poor sentiment for real estate shares over the next three months, combined with a relatively high valuation profile. The valuation polarisation, i.e. the range between high valuation and relatively low valuation, remains high, but we do not see valuations that reflect a potential upcoming crisis. On average, the spot NRV valuation within our covered universe points to a 19% premium (median 2% discount). Based in the risk of lower property values, we find this demanding.

Figure 1: P/NRV over time



Source: Handelsbanken Capital Markets

Material risk of pressure on earnings growth ahead

In terms of cash earning valuation (adjusted EPS), we see a material risk of pressure on earnings growth ahead, arising from what we assume will be higher funding costs for refinancing over the coming years, coupled with what we believe will be deteriorating opportunities for acquisition-driven earnings growth. The combination of these two factors should naturally have a large impact on growth. If we are right, this would be an obvious change from the operational results we have seen over the past few years and should also be reflected in share valuations, in our view.

Consolidation set to slow down

At present, we understand that the market for hybrid capital and opportunistic bond issues, with the aim to support market consolidation, is far from working well. We argue that the many transactions during 2021, taking down yield requirements materially, were supported by good liquidity and low costs in the capital markets. With an end to the QE programmes supporting liquidity, and slimmer balance sheets among central banks on the cards, we see no obvious reasons for near-term improvements in funding. This leads us to adopt the current funding cost level into our estimates.

Recommendation changes

Table 1: Recommendation changes

	Short-term		Long-term		Target price (3 years)		
	New	Old	New	Old	New	Old	Potential
Atrium Ljungberg	Hold	Hold	MP	MP	250	250	35%
Balder	Sell	Hold	MP	MP	725	725	27%
Castellum	Hold	Buy	MP	MP	300	300	38%
Catena	Hold	Buy	MP	OP	710	710	32%
Diös	Sell	Sell	UP	UP	105	105	11%
Entra	Hold	Hold	MP	MP	240	250	35%
Fabege	Hold	Hold	OP	OP	205	205	59%
Heba	Sell	Hold	UP	MP	180	180	17%
Hufvudstaden	Hold	Hold	MP	MP	165	155	24%
John Mattson	Sell	Hold	UP	UP	180	180	12%
KlaraBo	Hold	Hold	MP	MP	44	48	36%
NP3	Sell	Hold	MP	MP	380	380	29%
Pandox	Hold	Buy	MP	MP	170	170	24%
Platzer	Sell	Hold	MP	OP	150	150	40%
Trianon	Sell	Hold	MP	MP	250	250	28%
Wallenstam	Hold	Hold	MP	MP	170	170	35%
Sagax	Hold	Hold	MP	MP	320	320	22%
Stendörren	Hold	Buy	MP	OP	360	360	37%
Wihlborgs	Sell	Hold	UP	UP	210	210	13%

Source: Handelsbanken Capital Markets

Balder – SELL (Hold), Market Perform remains

- 10% outperformance to the real estate index since February 2021
- 64% market funding (bonds, commercial papers, hybrids) and large absolute volume of debt make Balder sensitive to higher spreads
- 46% of interest rates matures in the coming two years
- Relatively low-yielding assets (residential) and a high LTV (61%) make Balder sensitive to higher interest rates
- New production, mainly residential, will be more difficult to execute, owing to higher costs and the potential lack of input materials

Castellum – HOLD (Buy), Market Perform remains

- 10% outperformance to the real estate index since February 2021
- 76% market funding (bonds, commercial papers, hybrids) and large absolute volume of debt make Castellum sensitive to higher spreads
- 46% of debt matures within the next 12 months (based on Q4 2021 numbers)
- A recent SEK bond issue (five years) points at a near 4% interest rate in refinancing in the current market (1.7% on average as of Q4 2021)

Catena – HOLD (Buy), Market Perform (Outperform)

- 23% outperformance to the real estate index since year-end 2021

- Slightly above-average share of market funding entails a certain risk
- Growth from new construction may be more difficult to achieve, owing to higher production cost and uncertainty about raw material supplies
- The share has outperformed recently, and the valuation has become demanding in the wake of poor near-term sentiment in general
- Catena remain a decent relative share to own in the sector and we see meaningful return potential over the next three years, but not enough for a positive stance, which requires >40% upside

Heba – SELL (Hold), Underperform (Market perform)

- 22% outperformance to the real estate index since February 2021, trading close to its all-time-high
- Heba has low-yielding residential assets of high quality, and we expect a solid underlying property performance
- Low property yields mean higher risk when rates are on the rise, and the yield spread (properties versus average paid interest rate) is tight (2.4% as of Q4 2021)
- 51% of interest rates mature in the next 24 months, which brings a high risk of slowing/negative earnings growth
- Recent downgrade of credit rating (NCR) poses an additional risk of higher funding costs

John Mattson – SELL (Hold), Underperform remains

- With its low-yielding residential assets of high quality, we expect a solid underlying property performance
- In Q4 2021, the yield gap was only 1.9%, and higher funding costs pose a large risk to earnings growth
- The operations are underfinanced, and John Mattson is currently breaching its financial policy for debt leverage, which may force it to divest property assets under less favourable market conditions, or propose a share issue under unfavourable market conditions
- Risk of alarmingly low ICR if funding costs increase

NP3 – SELL (Hold), Market Perform remains

- NP3's business model is based on acquisitions, and hence available funding on attractive terms is key to achieving high growth and defending the share valuation
- The share valuation remains demanding, despite a recent revaluation in the market
- NP3's LTV of 58% makes it more sensitive to deteriorating funding sentiment
- 64% interest rate maturity in the next 12 months as of Q4 2021
- ICR could be an issue if interest rate sentiment does not improve

Pandox – HOLD (Sell), Market Perform remains

- The share has outperformed the real estate index by 20% since year-end 2021
- We expect a couple of encouraging quarters in the near term, driven by improving occupancy and the return of hotel visitors, which will have a positive impact on earnings growth
- However, we see increasing risks relating to the macro economy and the risk of a recession or stagflation, which could, again, have a material impact on the demand for hotel nights
- Pandox has relatively high gearing, and short maturities on both debt and interest rates pose a funding risk

Platzer – SELL (Hold), Market Perform (Outperform)

- Platzer's outperformance over the past month has eroded some of the long-term (three years) upside and we downgrade to Market Perform
- Maturities for both interest rates and debt are short, which was previously a positive given the Investment Grade rating received in 2021, but now increase the risk of elevated funding costs, which leads us to downgrade the share to SELL in a short-term perspective
- LTV was slightly above the sector average as of Q4 2021, and we see meaningful risks of an increase in the average 1.7% paid interest rate at year-end 2021

Trianon – SELL (Hold), Market Perform remains

- Trianon has operated with a very short duration on both interest rate and debt maturities, which pose a material risk of higher funding costs, while the fact that a majority of debt funding comes from banks reduces the near-term risk somewhat
- LTV was 9pp above the sector average as of Q4 2021, which also entails higher risk
- Low-yielding property assets mean that the yield gap to funding is rather small, which, combined with high debt leverage, means a high risk to earnings growth
- We still expect earnings to grow well above the sector average, but the share valuation is demanding in both absolute and relative terms

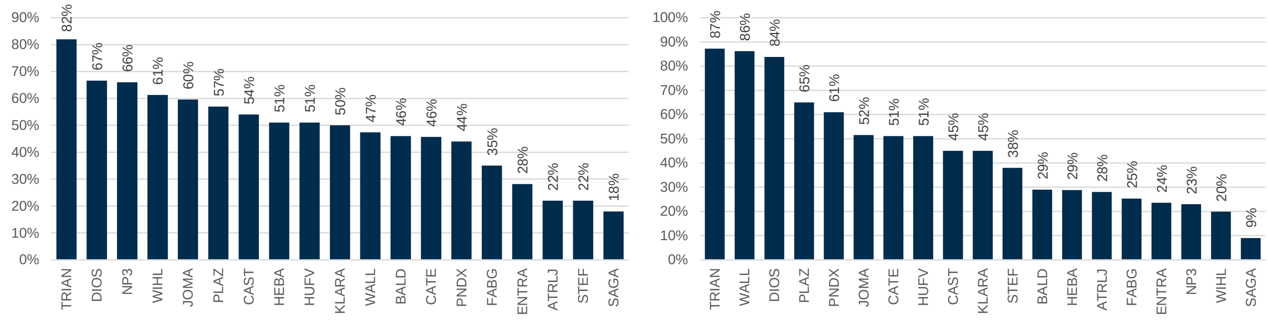
Stendörren – HOLD (Buy), Market Perform (Outperform)

- Attractive yield gap between property returns and funding, as well as strong operational momentum, remain positives in the case
- The share has outperformed the real estate index by 50% over the past 12 months and by 20% since mid-February
- However, Stendörren is far from immune to deteriorating sentiment and higher funding costs
- The share valuation relative to the sector average is now starting to appear demanding
- In addition, with a lot of developments intended to support future growth, we see an increasing risk of higher costs and disturbances in new production from input materials

Wihlborgs – SELL (Hold), Underperform remains

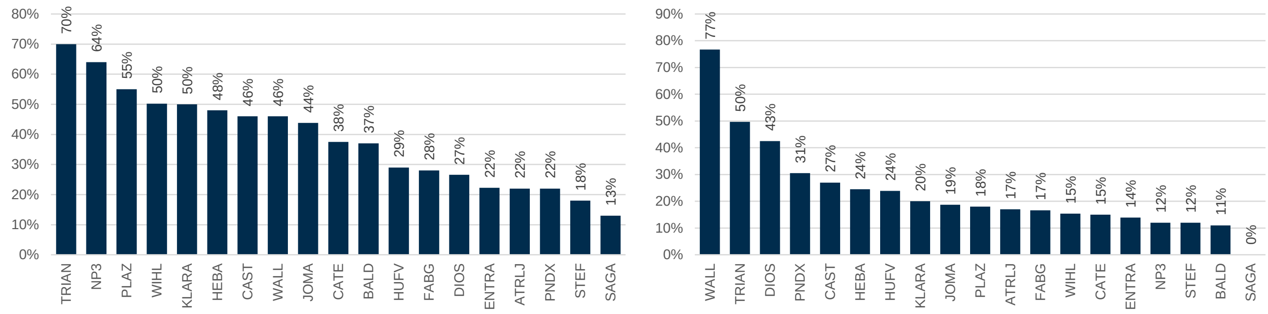
- Wihlborgs combines a large portion of outstanding market debt with a short maturity on interest rates, which poses a material risk of higher funding costs and slowing earnings growth
- The average paid interest rate of 1.3% is partly a result of the low interest rates in recent years and the short maturity profile for rates
- The valuation does not reflect any potential property value decline, and we argue that the share is trading at a premium to peers on NRV (while the relatively low cash earning valuation is a result of short interest rate maturity)
- On a long-term view, we remain cautious on the local market and the risk of low/negative rental growth

Table 2: Interest rate (left-hand chart) and debt maturities (right-hand chart), next 24 months



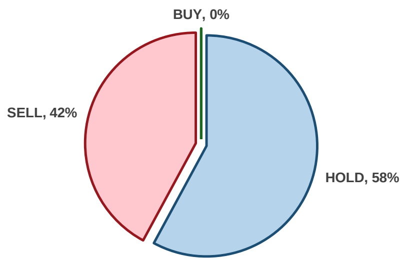
Source: Handelsbanken Capital Markets

Table 3: Interest rate (left-hand chart) and debt maturities (right-hand chart), next 12 months



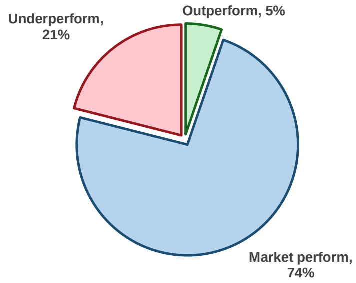
Source: Handelsbanken Capital Markets

Figure 2: Short-term rec. structure



Source: Handelsbanken Capital Markets

Figure 3: Long-term rec. structure



Source: Handelsbanken Capital Markets

Estimate changes

Interest rates have risen significantly in recent weeks, and refinancing has started to become much more expensive for listed real estate companies. Rising market rents (including swap rates, some 50bp higher than government bonds), high inflation and wider bond spreads are all reasons for the higher funding costs. A recent SEK bond issue by Castellum indicated a near 4% rate for a fixed five-year bond, compared to the average paid interest rate of 1.7%. As a result of company policies and pressure from rating agencies, we believe that most companies will be forced to swap out a majority of new/renegotiated debt in order to keep interest rate maturities at a healthy level. That means that the paid interest rate will climb as a result of higher spreads, higher market (swap) rates and potentially higher STIBOR/EURIBOR. We adjust our assumptions for the paid interest rate based on our simulation of the current pricing in the market, for both spreads and swap rates, and we simulate the impact on the companies based on the current profile for debt and interest rate maturities. We also incorporate Handelsbanken's official inflation estimate profile into rental income and property and administrational costs. We take down our 2022-2024 adjusted EPS estimates by 3.8-11.2%. High debt leverage, low yielding assets and short maturities all have a large impact on estimated cash earnings. In addition, we strongly believe that acquisition-driven growth will fade significantly, taking down the growth profile in the sector further.

Refinancing puts pressure on earnings growth

More expensive funding will gradually feed into the net financials

We make the assumption that more expensive funding will gradually feed into the net financials and eat into cash earnings. We take the capital structure into account, including the maturity profile for debt and interest rates and also the blend of market debt and bank debt, given that we believe that large market debt maturities cannot fully be substituted by the less price-volatile bank debt, due to volume and the limitations of secured bank debt relating to the investment grade ratings. Hence, we expect that companies with a large portion of market debt with short maturities will see a more rapid increase in funding costs compared with "bank-funded" companies with a more even spread/tail-heavy profile for funding. Given that we see both swap rates (SEK five years at 2.1%, EUR at 1.28%) and bond spreads are up significantly, and with no obvious reason for near-term tightening, we use "spot prices" for funding for our estimate revisions.

Table 4: Debt financing profile

	Financing source/type			Maturities		Debt metrics			Interest rate maturity (years)							Debt maturity (years)						
	Bond	Bank	Cert.	Interest maturity	Debt maturity	Interest rate	Net LTV	ICR	0-1	1-2	2-3	3-4	4-5	>5	0-2	0-1	1-2	2-3	3-4	4-5	>5	0-2
ATRLJ	53%	26%	21%	4.7	4.8	1.7%	40%	5.3	22%	0%	7%	7%	8%	56%	22%	17%	11%	17%	11%	13%	31%	28%
BALD	61%	36%	3%	3.6	5.7	1.4%	61%	5.1	37%	9%	4%	8%	12%	30%	46%	11%	18%	11%	11%	11%	38%	29%
CAST	61%	24%	15%	3.3	3.8	1.7%	39%	5.2	46%	8%	2%	4%	9%	31%	54%	27%	18%	10%	11%	10%	24%	45%
CATE	40%	51%	9%	3.0	3.3	1.9%	43%	4.5	38%	8%	5%	12%	10%	27%	46%	15%	36%	24%	13%	2%	11%	51%
DIOS	5%	81%	14%	0.9	2.0	1.1%	49%	6.4	27%	40%	20%	0%	7%	7%	67%	43%	41%	15%	0%	1%	1%	84%
ENTRA	74%	21%	5%	3.1	6.1	2.3%	38%	3.5	22%	6%	3%	9%	15%	44%	28%	14%	10%	4%	11%	25%	36%	24%
FABG	41%	52%	7%	3.7	4.9	1.7%	37%	4.1	28%	7%	10%	9%	10%	36%	35%	17%	9%	23%	5%	17%	30%	25%
HEBA	33%	42%	25%	3.4	4.3	0.9%	41%	4.8	48%	3%	6%	2%	7%	34%	51%	24%	4%	11%	15%	6%	40%	29%
HUFV	84%	11%	5%	2.2	2.6	1.3%	18%	9.3	29%	22%	11%	11%	27%	0%	51%	24%	27%	11%	11%	27%	0%	51%
JOMA	0%	100%	0%	2.0	2.1	1.4%	58%	2.2	44%	16%	13%	0%	13%	14%	60%	19%	33%	22%	13%	13%	1%	52%
KLARA	0%	100%	0%	1.9	3.2	1.9%	42%	2.1	50%	0%	13%	37%	0%	0%	50%	20%	25%	10%	30%	15%	0%	45%
NP3	22%	69%	9%	2.0	2.9	2.5%	58%	3.3	64%	2%	5%	7%	5%	17%	66%	12%	11%	26%	18%	33%	0%	23%
PNDX	0%	85%	15%	3.3	2.2	2.5%	50%	2.1	22%	22%	5%	5%	10%	36%	44%	31%	31%	3%	3%	3%	31%	61%
PLAZ	24%	65%	11%	3.0	2.3	1.9%	49%	4.1	55%	2%	2%	6%	0%	35%	57%	18%	47%	9%	12%	6%	8%	65%
TRIAN	7%	93%	0%	2.7	2.1	1.9%	54%	3.2	70%	12%	3%	5%	5%	5%	82%	50%	38%	8%	2%	2%	2%	87%
WALL	7%	79%	14%	3.3	1.3	1.2%	43%	5.7	46%	1%	4%	9%	6%	34%	47%	77%	10%	4%	5%	1%	4%	86%
SAGA	88%	0%	12%	6.3	6.8	1.4%	57%	6.5	13%	5%	19%	14%	0%	49%	18%	0%	9%	25%	16%	0%	50%	9%
STEF	23%	77%	0%	3.7	2.5	2.3%	53%	3.0	18%	4%	16%	62%	0%	0%	22%	12%	26%	24%	33%	4%	1%	38%
WIHL	53%	47%	0%	2.9	6.0	1.3%	47%	6.7	50%	11%	8%	8%	5%	18%	61%	15%	4%	42%	2%	2%	34%	20%
Total	**36%**	**56%**	**9%**	**3.1**	**3.6**	**1.7%**	**46%**	**4.6**	**38%**	**9%**	**8%**	**11%**	**8%**	**25%**	**48%**	**23%**	**21%**	**16%**	**12%**	**10%**	**18%**	**45%**

Source: Handelsbanken Capital Markets, company data

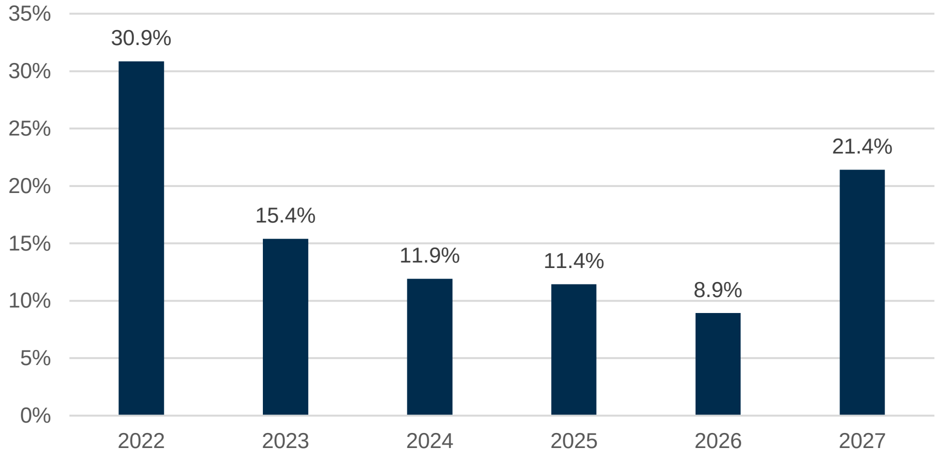
Hedging makes a gradual impact on earning

On average, we see new funding (all-in cost) at 3.2%

Based on the profile for both interest rate and debt maturities in 2022-2027 for the companies under our coverage, we have estimated that almost 31% of debt volume, on average, will see the rate coming up for the one reason, or the other (higher spreads and/or higher swap rate). On average, we see new funding (all in cost) at

3.2%, compared with the current average of 1.7% (Q4 2021) for our covered universe. Given the maturity profiles for both debt and rates, higher funding costs will have a gradual impact on the earnings profiles. Our previous assumptions for funding cost also have an impact on the estimate revisions.

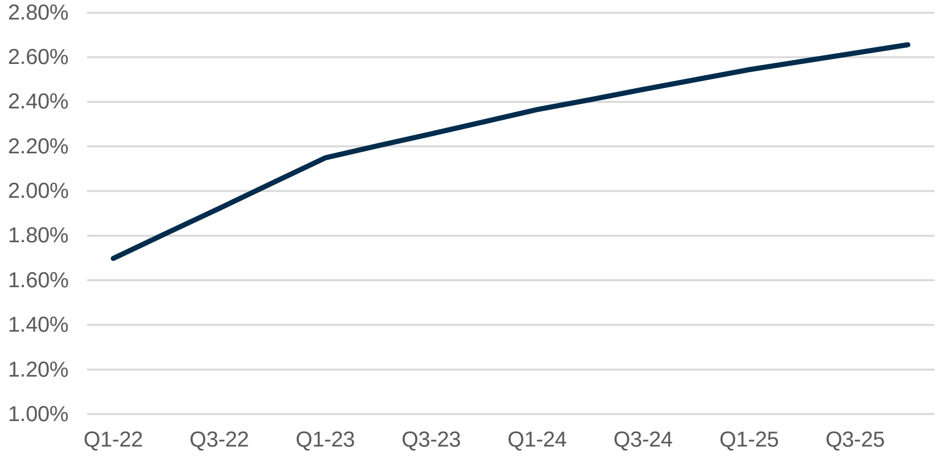
Figure 4: Volume of debt and interest maturities, leading to higher cost



Source: Handelsbanken Capital Markets

On average, and based on our estimates and assumptions, the paid interest rate will go from 1.7% to 2.66% in 2025, a 57% increase over five years. New funding (i.e. not refinancing) could push the average higher.

Figure 5: Estimates for paid interest rate on average, Q1 2022-Q4 2025



Source: Handelsbanken Capital Markets

We have yet not made assumptions regarding declining property values

We highlight that we have yet not made any assumptions regarding declining property values. Such a scenario is not at all unlikely, and could have a meaningful impact on capital structures, credit ratings, funding costs and earnings growth. All such potential impacts are still outside our official estimates, but should be considered as real risks to the sector and the listed companies.

Table 5: Estimate revision and growth, adjusted EPS and EPRA NRV

	EPRA NRV (revision)			EPRA NRV growth			EPS adj. (revision)			EPS adj. growth		
	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e
ATRLJ	0.5%	-4.8%	-10.5%	6.9%	3.7%	3.1%	-2.4%	-2.5%	-3.8%	-6.0%	11.9%	5.4%
BALD	-2.3%	-5.7%	-10.2%	9.5%	7.2%	4.9%	-3.8%	-9.5%	-12.2%	7.7%	-1.1%	0.4%
CAST	-3.1%	-8.2%	-12.5%	5.4%	3.0%	3.2%	-2.7%	-6.1%	-7.4%	14.0%	8.4%	8.7%
CATE	2.6%	-1.2%	-1.7%	12.8%	5.3%	6.3%	-5.1%	-6.1%	-11.3%	7.6%	8.4%	3.8%
DIOS	0.0%	-0.4%	-1.2%	5.0%	3.8%	3.1%	-0.6%	-4.7%	-11.7%	4.6%	-0.4%	-6.1%
ENTRA	-4.8%	-9.8%	-14.2%	7.7%	2.6%	2.9%	-8.3%	-9.9%	-11.2%	32.7%	5.3%	10.9%
FABG	-1.9%	-3.2%	-4.7%	3.8%	3.0%	2.7%	-4.3%	-7.0%	-10.5%	2.7%	3.8%	1.7%
HEBA	-0.2%	-0.5%	-0.9%	9.9%	11.8%	5.4%	-6.0%	-12.4%	-15.3%	11.5%	31.6%	13.0%
HUFV	0.0%	-0.1%	-0.2%	3.1%	3.7%	3.0%	-0.6%	-2.5%	-5.2%	2.1%	3.0%	2.4%
JOMA	6.8%	3.3%	2.5%	4.4%	4.1%	3.9%	-26.2%	-34.2%	-13.7%	46.8%	2.3%	-2.0%
KLARA	-0.3%	-0.6%	-1.1%	14.3%	14.6%	13.7%	-8.3%	-12.1%	-15.5%	165.0%	22.3%	17.9%
NP3	-0.1%	-0.1%	-0.3%	15.7%	13.9%	12.7%	-1.0%	-0.6%	-1.6%	3.6%	15.0%	9.3%
PNDX	0.1%	0.3%	0.6%	5.8%	5.3%	3.9%	2.0%	4.3%	5.6%	135.7%	26.6%	6.4%
PLAZ	-2.4%	-5.0%	-7.7%	13.8%	6.7%	6.4%	-3.6%	-6.9%	-9.7%	17.8%	15.0%	4.4%
TRIAN	-6.0%	-13.1%	-19.3%	7.4%	5.5%	5.6%	-16.3%	-28.0%	-30.1%	28.2%	13.3%	18.7%
WALL	-0.4%	-2.2%	-3.7%	4.7%	3.1%	4.2%	-8.4%	-22.8%	-26.1%	1.9%	-10.9%	4.1%
SAGA	0.0%	0.0%	-0.1%	11.3%	11.5%	11.0%	-0.2%	0.4%	-1.8%	19.3%	17.1%	12.2%
STEF	0.0%	-1.7%	-1.7%	16.6%	10.4%	12.4%	-16.8%	-14.6%	-14.6%	23.2%	28.4%	12.5%
WIHL	-3.1%	-6.7%	-10.5%	5.1%	4.0%	3.2%	-2.6%	-4.5%	-7.0%	1.2%	3.7%	0.4%
Average	**-0.8%**	**-3.1%**	**-5.1%**	**8.6%**	**6.5%**	**5.9%**	**-6.1%**	**-9.5%**	**-10.7%**	**27.3%**	**10.7%**	**6.5%**
Median	**-0.2%**	**-1.7%**	**-1.7%**	**7.4%**	**5.3%**	**4.2%**	**-3.8%**	**-6.9%**	**-11.2%**	**11.5%**	**8.4%**	**5.4%**

Source: Handelsbanken Capital Markets

Growth has come down significantly in our new estimates

We still see growth to both NRV and adjusted EPS, despite our estimate revisions. However, growth has come down significantly and our new growth estimates for NRV and adjusted EPS have taken a hit of 24% and 22%, on average for 2022-2024. Hence, our previous view on growth is now significantly muted.

The “real yield spread” points towards pressure on values

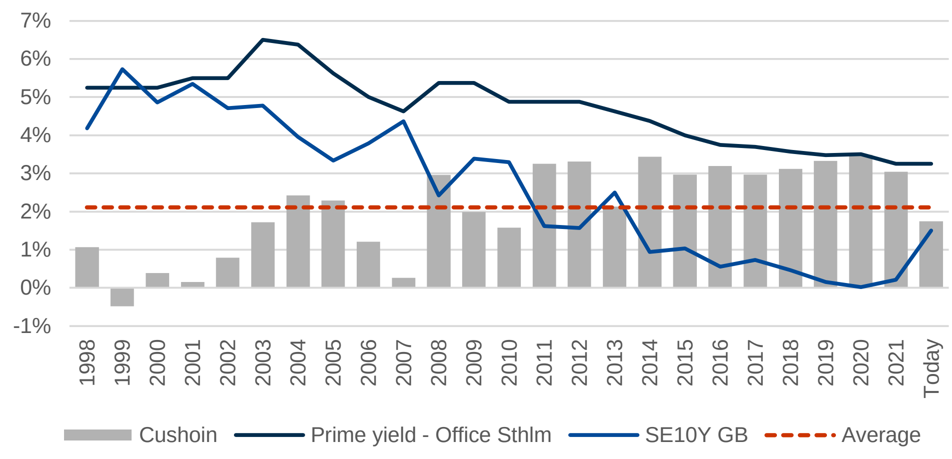
We see a clear correlation between paid interest rates and reported property book yields (valuation yield) within the listed real estate universe. On average, the spread has been “fixed” at 3% since 2015, despite the increasing spread between market rates and property yields up until recently. This points towards pressure on property values in the event that paid interest rates increase, which we definitely think it will. We believe such a scenario will have a meaningful impact on growth and funding costs, and not all of these effects are visible in our estimates.

Diminishing yield cushion(s)

Historical argument for value growth now indicates the opposite

A key argument for yield contraction in the real estate transaction market has been that the ‘yield cushion’, i.e. the gap between the Swedish 10-year government bond and valuation yield in Swedish real estate, was at historically high levels. However, with the recent spike in interest rates, the gap has reduced significantly. On average, between 1998 and 2021, the yield cushion was 2.1%, while between 2014 and 2021 it averaged 3.2%. The latest listing sets the gap at 1.8%, giving a yield for 2021 of 3.25% (range of 3.0-3.5%). In our view, this indicates flat yields in a positive scenario, but an increasing probability of yield expansion implies that value deterioration is imminent.

Figure 6: Swedish 10y government bond vs. prime yield Office Stockholm

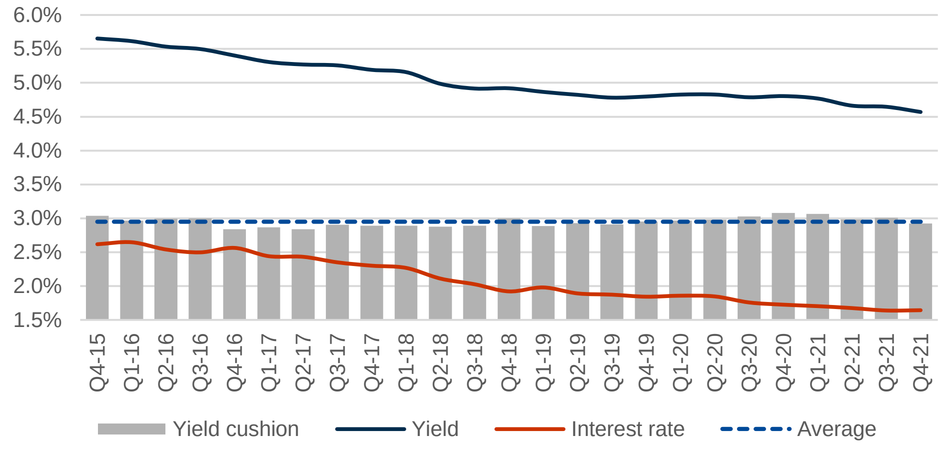


Source: Handelsbanken Capital Markets, Hufvudstaden, Factset

Increasing funding costs squeeze the gap to valuation yields

A more hands-on and less theoretical approach to the ‘yield cushion’ is to look at the gap between the average paid interest rate and the average, reported valuation yields. In this approach, we have looked at aggregated data for listed Swedish real estate companies. We find that the relationship between the weighted average reported yield requirements and the weighted average reported paid interest rate has been remarkably stable in the period for which we have data (Q4 2015 – Q4 2021). The ‘yield cushion’ has varied between 2.8% and 3.1%, with an average of 2.9%. In the current funding market, where we are seeing drastically increasing funding costs in the beginning of 2022, we find that this is also indicative of yield expansion in the Swedish real estate market when higher rates find their ways into the companies’ balance sheets.

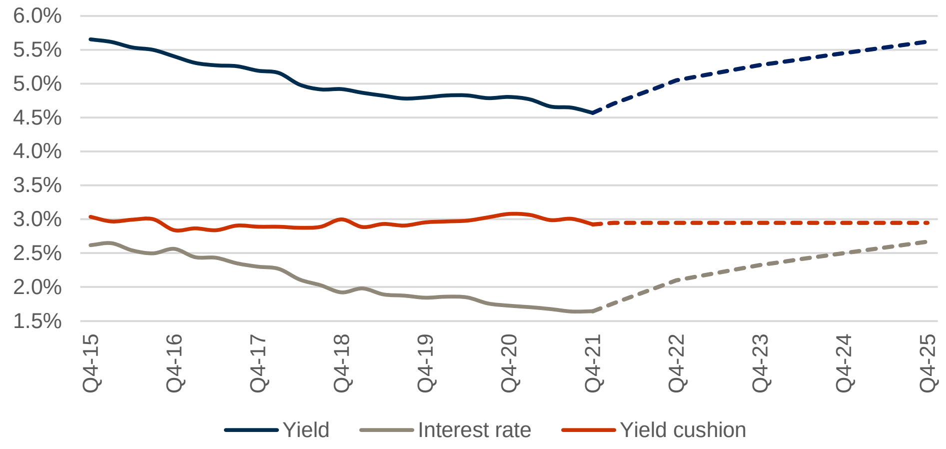
Figure 7: Weighted average yield requirement and paid interest rate



Source: Handelsbanken Capital Markets, Sedis, FactSet

The yield-gap graph above is based on the paid financial net among the listed companies (i.e. not the market interest rate or any swap rate), and thus includes the effect of interest rate and capital hedging. In addition, we use the reported required yield (average of listed companies in the sector), i.e. not necessarily the required property yield we see in the transactions, as it reasonably includes the lag effect we assume exists between reality and book values.

Figure 8: Higher paid interest rates should put pressure on values



Source: Handelsbanken Capital Markets, Sedis, FactSet

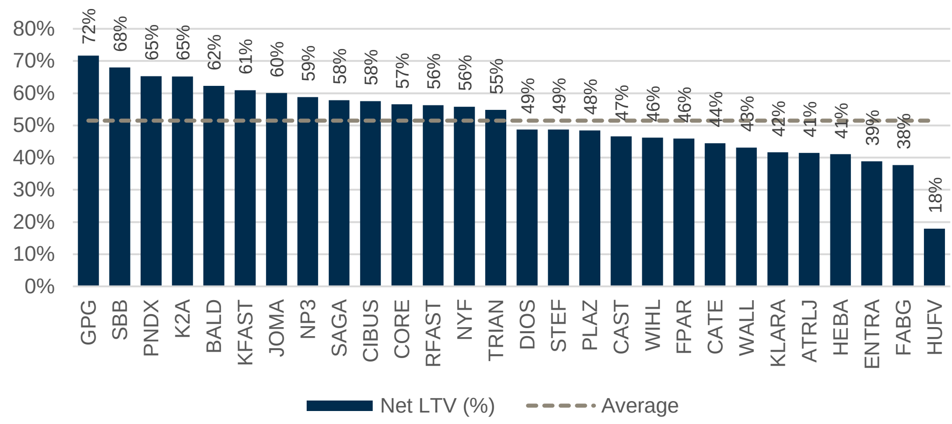
A continued relationship between paid interest rates and yield points at declining values

In a forward-looking exercise, in which we incorporate our estimates on paid interest rates, based on the current pricing in the market for bonds, swap rates and STIBOR/EURIBOR, a continued relationship between paid interest rates and yield requirement (book property values) indicates declining property values. The chart above takes no other potential impact into account, other than the rate effect on property yield.

Capital and debt structure in our coverage

In screening the capital and debt structure in our coverage, we draw the general observation that roughly 50% of both interest rates and debt matures within the coming 24 months. Within the coming 12 months, roughly 40% of the interest rates and 25% of the debt mature. We believe our coverage is a fair representation of the sector as a whole, which exposes Swedish real estate companies and indirectly the transaction market to near-term funding terms.

Figure 9: Net LTV



Source: Sedis

Table 6: Debt metrics overview

	Financing source/type			Maturities		Debt metrics		
	Bond	Bank	Cert.	Interest maturity	Debt maturity	Interest rate	Net LTV	ICR
ATRLJ	53%	26%	21%	4.7	4.8	1.7%	40%	5.3
BALD	61%	36%	3%	3.6	5.7	1.4%	61%	5.1
CAST	61%	24%	15%	3.3	3.8	1.7%	39%	5.2
CATE	40%	51%	9%	3.0	3.3	1.9%	43%	4.5
DIOS	5%	81%	14%	0.9	2.0	1.1%	49%	6.4
ENTRA	74%	21%	5%	3.1	6.1	2.3%	38%	3.5
FABG	41%	52%	7%	3.7	4.9	1.7%	37%	4.1
HEBA	33%	42%	25%	3.4	4.3	0.9%	41%	4.8
HUFV	84%	11%	5%	2.2	2.6	1.3%	18%	9.3
JOMA	0%	100%	0%	2.0	2.1	1.4%	58%	2.2
KLARA	0%	100%	0%	1.9	3.2	1.9%	42%	2.1
NP3	22%	69%	9%	2.0	2.9	2.5%	58%	3.3
PNDX	0%	85%	15%	3.3	2.2	2.5%	50%	2.1
PLAZ	24%	65%	11%	3.0	2.3	1.7%	49%	4.1
TRIAN	7%	93%	0%	2.7	2.1	1.9%	54%	3.2
WALL	7%	79%	14%	3.3	1.3	1.2%	43%	5.7
SAGA	88%	0%	12%	6.3	6.8	1.4%	57%	6.5
STEF	23%	77%	0%	3.7	2.5	2.3%	53%	3.0
WIHL	53%	47%	0%	2.9	6.0	1.3%	47%	6.7
Total	**36%**	**56%**	**9%**	**3.1**	**3.6**	**1.7%**	**46%**	**4.6**

	Interest rate maturity (years)							Debt maturity (years)						
	0-1	1-2	2-3	3-4	4-5	>5	0-2	0-1	1-2	2-3	3-4	4-5	>5	0-2
ATRLJ	22%	0%	7%	7%	8%	56%	22%	17%	11%	17%	11%	13%	31%	28%
BALD	37%	9%	4%	8%	12%	30%	46%	11%	18%	11%	11%	11%	38%	29%
CAST	46%	8%	2%	4%	9%	31%	54%	27%	18%	10%	11%	10%	24%	45%
CATE	38%	8%	5%	12%	10%	27%	46%	15%	36%	24%	13%	2%	11%	51%
DIOS	27%	40%	20%	0%	7%	7%	67%	43%	41%	15%	0%	1%	1%	84%
ENTRA	22%	6%	3%	9%	15%	44%	28%	14%	10%	4%	11%	25%	36%	24%
FABG	28%	7%	10%	9%	10%	36%	35%	17%	9%	23%	5%	17%	30%	25%
HEBA	48%	3%	6%	2%	7%	34%	51%	24%	4%	11%	15%	6%	40%	29%
HUFV	29%	22%	11%	11%	27%	0%	51%	24%	27%	11%	11%	27%	0%	51%
JOMA	44%	16%	13%	0%	13%	14%	60%	19%	33%	22%	13%	13%	1%	52%
KLARA	50%	0%	13%	37%	0%	0%	50%	20%	25%	10%	31%	15%	-1%	45%
NP3	64%	2%	5%	7%	5%	17%	66%	12%	11%	26%	18%	33%	0%	23%
PNDX	22%	22%	5%	5%	10%	36%	44%	31%	31%	3%	3%	3%	31%	61%
PLAZ	55%	2%	2%	6%	0%	35%	57%	18%	47%	9%	12%	6%	8%	65%
TRIAN	70%	12%	3%	5%	5%	5%	82%	50%	38%	8%	2%	2%	2%	87%
WALL	46%	1%	4%	9%	6%	34%	47%	77%	10%	4%	5%	1%	4%	86%
SAGA	13%	5%	19%	14%	0%	49%	18%	0%	9%	25%	16%	0%	50%	9%
STEF	18%	4%	16%	62%	0%	0%	22%	12%	26%	24%	33%	4%	1%	38%
WIHL	50%	11%	8%	8%	5%	18%	61%	15%	4%	42%	2%	2%	34%	20%
Total	**38%**	**9%**	**8%**	**11%**	**8%**	**25%**	**48%**	**23%**	**21%**	**16%**	**12%**	**10%**	**18%**	**45%**

Source: Handelsbanken Capital Markets

Table 7: Property data

	Property data		Yield less interest			
	Property yield	Vacancy rate	Yield gap	Yield gap +200bp	Earnings effect (-)	Implied ICR
ATRLJ	4.2%	9.0%	3.5%	3.3%	5.7%	4.1
BALD	4.4%	4.0%	3.5%	3.1%	13.0%	3.3
CAST	4.7%	6.8%	4.0%	3.7%	9.6%	3.3
CATE	4.9%	5.3%	4.1%	3.7%	10.2%	3.0
DIOS	5.4%	10.0%	4.9%	4.2%	14.9%	2.7
ENTRA	4.4%	2.2%	3.6%	3.4%	5.6%	2.8
FABG	4.0%	10.0%	3.4%	3.2%	6.5%	3.0
HEBA	2.8%	0.8%	2.4%	2.1%	13.6%	2.6
HUFV	3.5%	15.0%	3.3%	3.1%	5.6%	5.2
JOMA	2.7%	4.4%	1.9%	1.2%	34.1%	1.2
KLARA	4.1%	5.4%	3.3%	2.9%	11.9%	1.4
NP3	6.4%	7.0%	4.9%	4.4%	10.6%	2.4
PNDX	5.6%	0.1%	4.3%	3.8%	12.0%	1.5
PLAZ	4.6%	8.0%	3.7%	3.1%	16.2%	2.5
TRIAN	3.9%	5.0%	2.9%	2.0%	31.4%	1.7
WALL	3.5%	2.0%	3.0%	2.4%	19.2%	2.7
SAGA	6.3%	7.0%	5.5%	5.3%	2.8%	5.5
STEF	5.7%	11.0%	4.5%	4.2%	7.2%	2.4
WIHL	4.8%	8.0%	4.2%	3.8%	9.0%	4.1
Total	**4.5%**	**6.4%**	**3.7%**	**3.3%**	**12.6%**	**2.9**

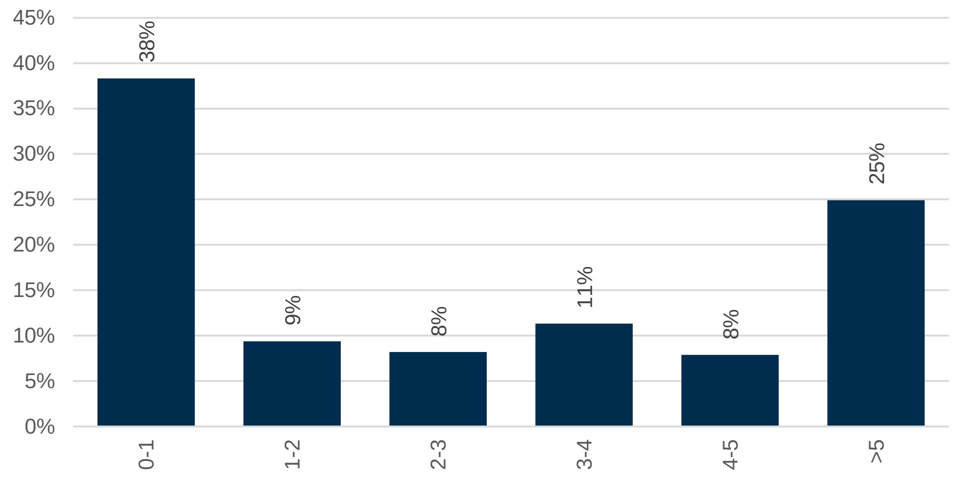
Source: Handelsbanken Capital Markets

Handelsbanken Capital Markets

Nordic real estate companies have short maturities

Nordic real estate companies generally have shorter debt and interest rate maturity profiles compared to their European peers. Although we think we know why, and understand the reasons (as this has historically benefited the Nordic companies), it points towards an increased risk.

Figure 10: Interest rate maturity profile

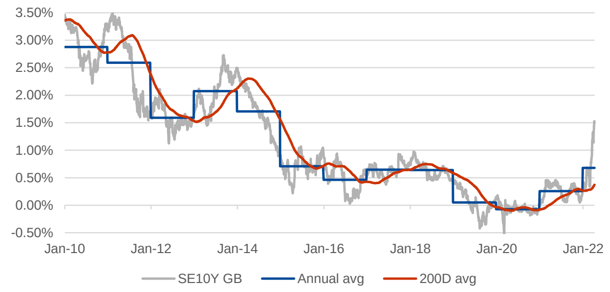


Source: Handelsbanken Capital Markets, company data

38% interest matures within 12 months

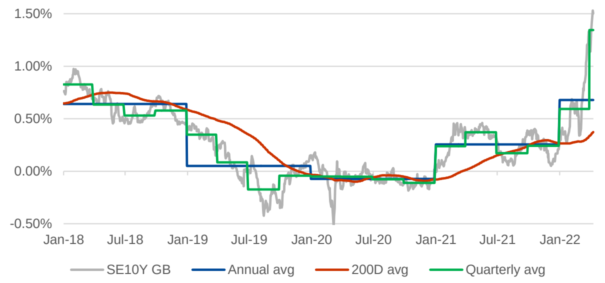
Based on a compilation of data from public companies, 38% of debt volume has interest rate maturities within 12 months (based on reported Q4 2021 numbers). This volume is most likely a mix of debt volume with no hedging, hedging contracts with a short time to maturity, and a decent volume of commercial papers. Disregarding the reason for the short maturity, this will have an impact on the average funding cost development in 2022 and onwards, given where we see swap rates are trading currently.

Figure 11: Swedish 10Y GVB 2010-YTD



Source: Handelsbanken Capital Markets

Figure 12: Swedish 10Y GVB 2018-YTD



Source: Handelsbanken Capital Markets

Paid interest rate will rise as a result of higher market interest rates

We do not know how each and every company will react to the higher swap rates. We assume, however, that companies will be forced to swap out short interest debt to longer maturities in order to keep the average interest rate maturity at healthy levels. In our view, this means that the paid interest rate will rise as a result of higher market interest rates (swap rates).

Table 8: Swap rates, SEK and EUR

Swap [SEK] Maturity	Price, %	Swap [EUR] Maturity	Price, %
1 Yr	0.8	1 Yr	0.03
2 Yr	1.58	2 Yr	0.76
3 Yr	1.89	3 Yr	1.06
4 Yr	2.02	4 Yr	1.2
5 Yr	**2.09**	**5 Yr**	**1.28**
6 Yr	2.13	6 Yr	1.33
7 Yr	2.16	7 Yr	1.38
8 Yr	2.19	8 Yr	1.43
9 Yr	2.21	9 Yr	1.48
10 Yr	**2.22**	**10 Yr**	**1.52**
12 Yr	2.24	12 Yr	1.58
15 Yr	2.27	15 Yr	1.62
20 Yr	2.24	20 Yr	1.55
30 Yr	2.09	30 Yr	1.31

Source: SEB, prices as of 2022-04-12

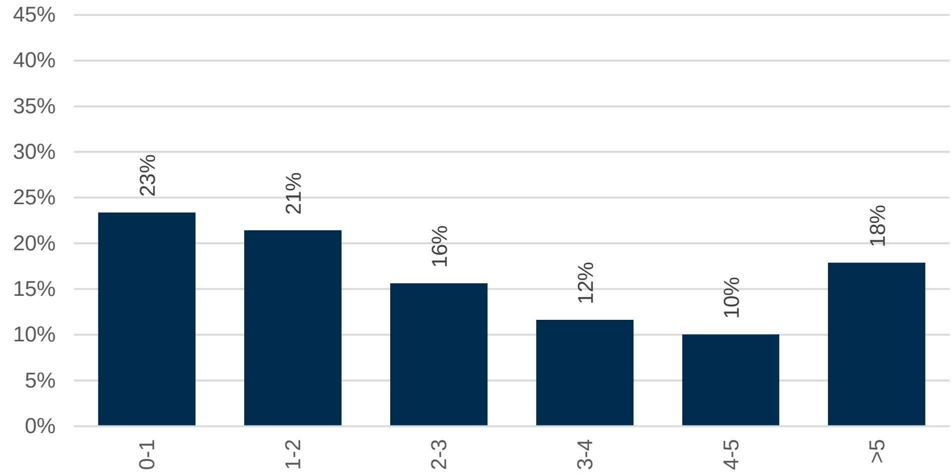
Table 9: Five-year swap rate 2021 to date, SEK

Source: Bloomberg, prices as of 2022-04-12

Table 10: Five-year swap rate 2021 to date, EUR

Source: Bloomberg, prices as of 2022-04-12

Figure 13: Debt maturity profile

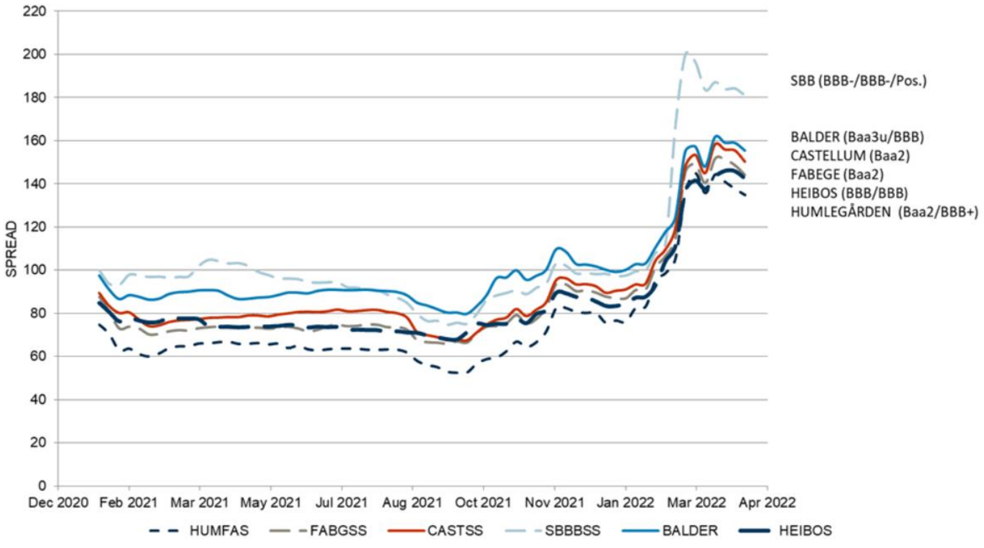


Source: Handelsbanken Capital Markets, company data

72% of all outstanding debt at the end of 2021 will mature within the next four years

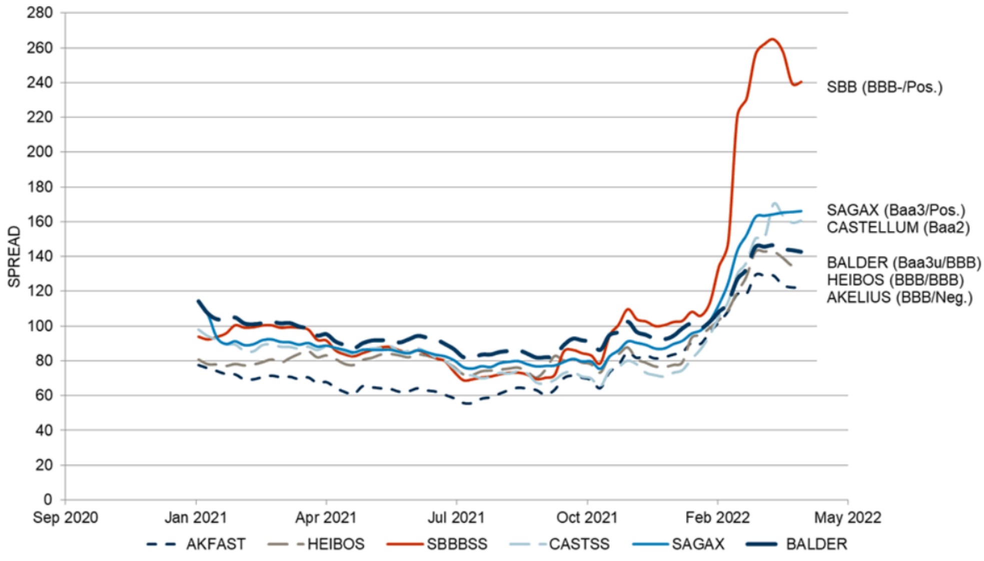
Regarding the debt maturity profile, maturities are more evenly spread out in the years to come. However, among the companies that we have examined, 72% of all outstanding debt at the end of 2021 will mature within the next four years. The current pricing in the capital markets – both real bond issues and screen pricing – indicates much higher prices for refinancing, with spreads at around 160bp or higher, which includes neither the STIBOR/EURIBOR, nor the swap rate. All maturing debt is not done at the extremely low pricing (spreads) that prevailed in 2021. However, the average paid interest of 1.7% (Handelsbanken's coverage) suggests negative impacts from refinancing in 2022.

Table 11: Interpolated three-year SEK spreads (bid)



Source: Handelsbanken Capital Markets

Table 12: Interpolated five-year EUR spreads (bid)



Source: Handelsbanken Capital Markets

In summary, we expect refinancing with five-year maturities on both rates and debt in the bond market to be done at around 3-4%, depending on the company. This would mean a 76-135% (from the average of 1.7%) cost increase on refinanced volume, with a gradual impact on the total funding cost.

A data point from the real world supports our numbers and estimates, we deem. A recent SEK bond issue by Castellum was done at a 190bp spread over STIBOR. We assume that that will be swapped out in time, for an additional cost of some ~200bp.

Table 13: Recent Castellum bond issue, floater five years

PRICED: Castellum SEK600m 5Y FRN 3mS+190

By Priscila Azevedo Rocha and Bloomberg Automation

(Bloomberg) -- Deal priced.

- SEK600m 5Y FRN (April 19, 2027) at 3mS+190
  - Reoffer price par
  - Coupon: 3mS+190, quarterly, act/360
  - Coupon Convention: Following business day - adjusted
  - Maturity: Bullet
- Issuer: Castellum AB (CASTSS)
- First Pay: July 19, 2022
- Format: Reg S, domestic MTN
- Settlement: April 19, 2022 (T+6)
- Denoms: 2m x 2m
- ISIN: SE0013883519
- Listing: NOMX Stockholm

Source: Bloomberg

In conjunction with the floater bond issue, Castellum issued a five-year fixed rate SEK bond with a coupon of 3.84. Hence, both issues imply a refinancing interest rate of almost 4%. The past week's spread and swap rate development suggest an even higher price for new debt.

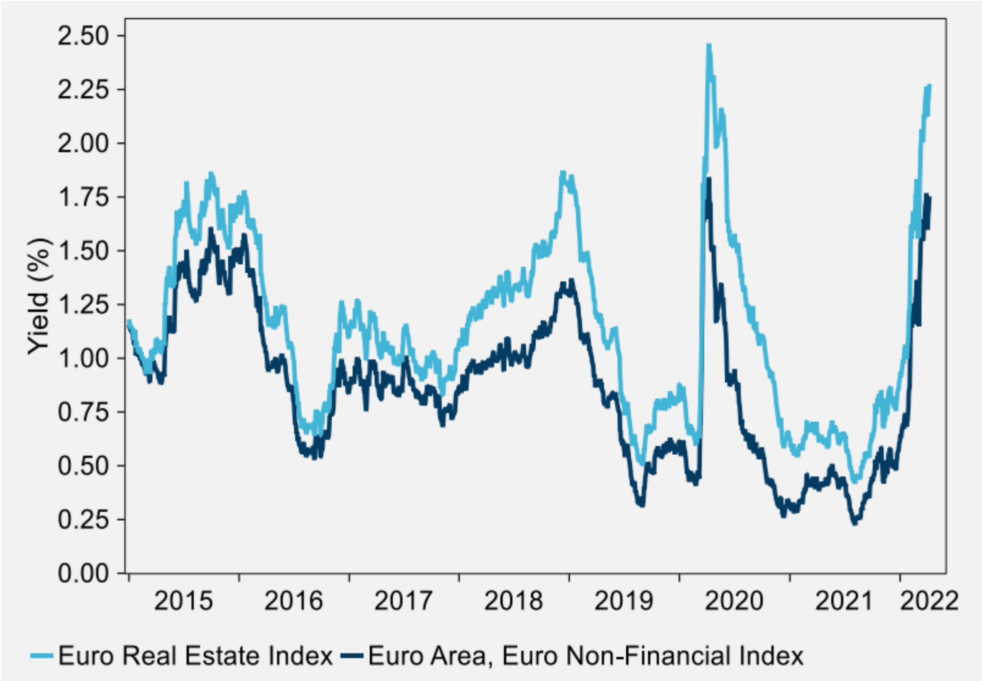
Table 14: Recent Castellum bond issue, fixed five years

25) Bond Description | 26) Issuer Description

Pages	Issuer Information			
11) Bond Info	Name	CASTELLUM AB		
12) Addtl Info	Industry	Other Financial (BCLASS)		
13) Reg/Tax	Security Information			
14) Covenants	Mkt Iss	DOMESTIC MTN		
15) Guarantors	Ctry/Reg	SE	Currency	SEK
16) Bond Ratings	Rank	Sr Unsecured	Series	DMTN
17) Identifiers	Coupon	3.840000	Type	Fixed
18) Exchanges	Cpn Freq	Annual		
19) Inv Parties	Day Cnt	ISMA-30/360	Iss Price	100.0000
20) Fees, Restrict	Maturity	04/19/2027	Reoffer	100
21) Schedules	BULLET			
22) Coupons	Iss Sprd	+190bp vs Mid Swaps		
Quick Links	Calc Type	(364)SWED 4 BUS-DAYS EX		
32) ALLQ Pricing	Pricing Date			04/08/2022
33) QRD Qt Recap	Interest Accrual Date			04/19/2022
34) TDH Trade Hist	1st Settle Date			04/19/2022
35) CACS Corp Action	1st Coupon Date			04/19/2023
36) CF Prospectus				
37) CN Sec News				
38) HDS Holders				

Source: Bloomberg

Table 15: EUR outright yield curve



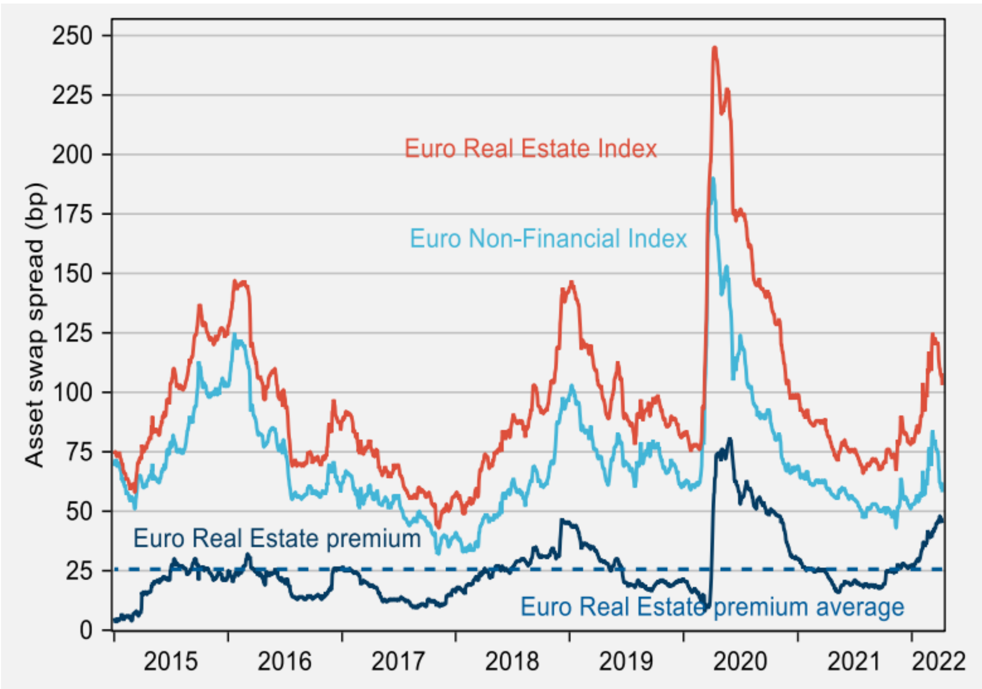
Source: ICE BofA, Macrobond

Costs are now well above the 2018 levels

The picture above displays an "all-in cost" index of high-rated European companies, with an average rating of BBB+ and lots of issuers with A- ratings. Cost is now well above the 2018 levels and we see no obvious reason why this should come down quickly again, which was the case in 2018/2019 and following the pandemic.

With underlying yields and credit spreads rising, issuers paying fixed rates for their financing are now seeing a substantial increase in all yields. Companies generally do not need to refinance all of their debt at once. However, there is no denying that outright funding yields going from around 0.5% to over 2% makes a difference for funding capital-intensive businesses like real estate.

Table 16: EUR Real Estate spread premium coming up, again

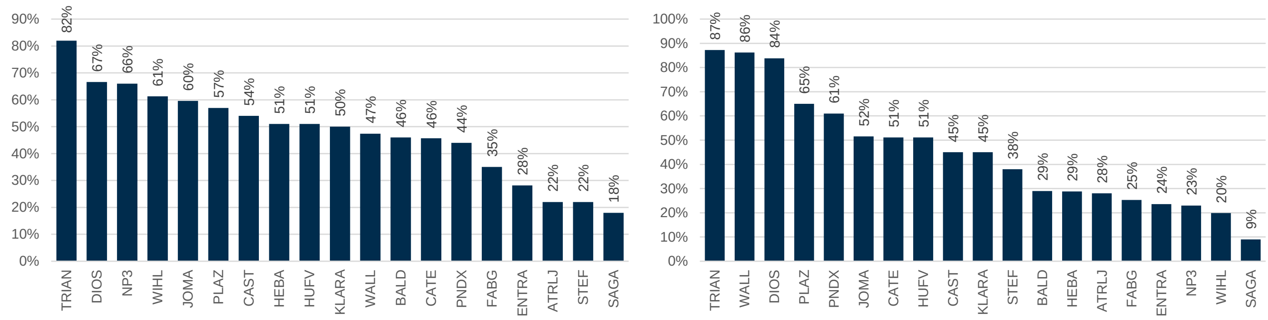


Source: ICE BofAML

Real estate continues to underperform spreads for other sectors

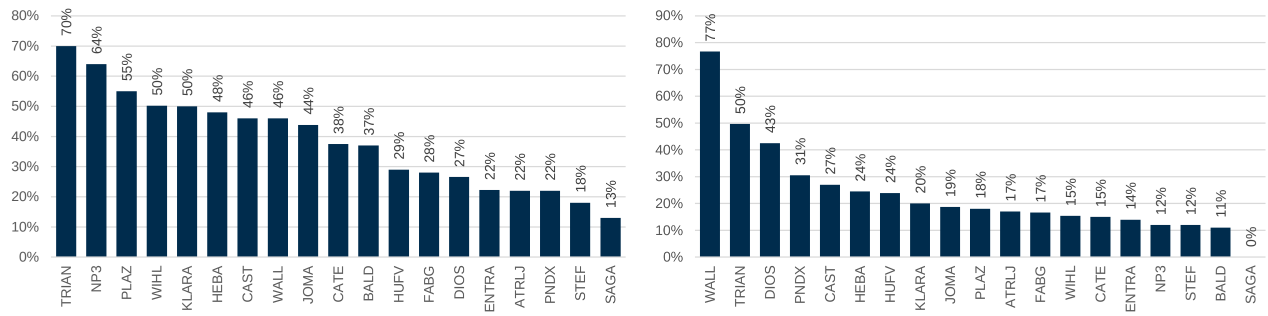
Spreads for the real estate sector continue to underperform spreads for other sectors. As real estate is “high beta”, much of the spread widening for the sector is typically just a reflection of wider spreads in general. However, even now when spreads have come down, the real estate sector has lagged with the effect that the sector premium has widened. We suspect that higher interest rates are a contributing factor.

Table 17: Interest rate (left-hand chart) and debt maturities (right-hand chart), next 24 months



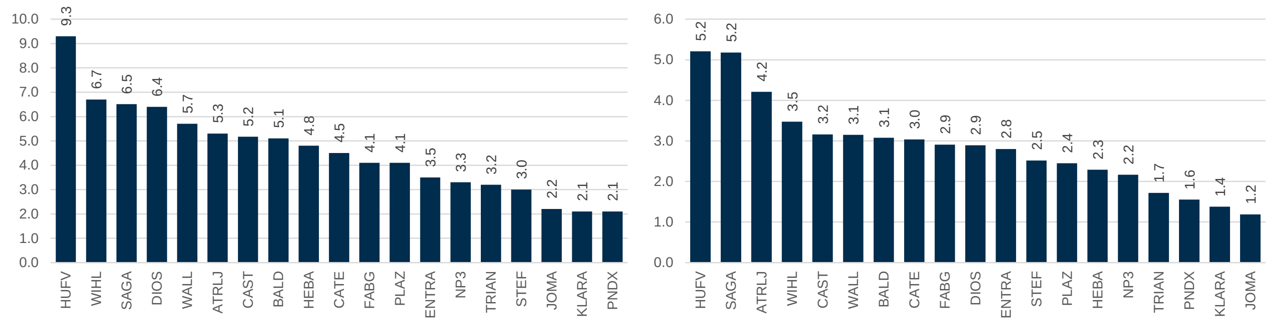
Source: Handelsbanken Capital Markets

Table 18: Interest rate (left-hand chart) and debt maturities (right-hand chart), next 12 months



Source: Handelsbanken Capital Markets

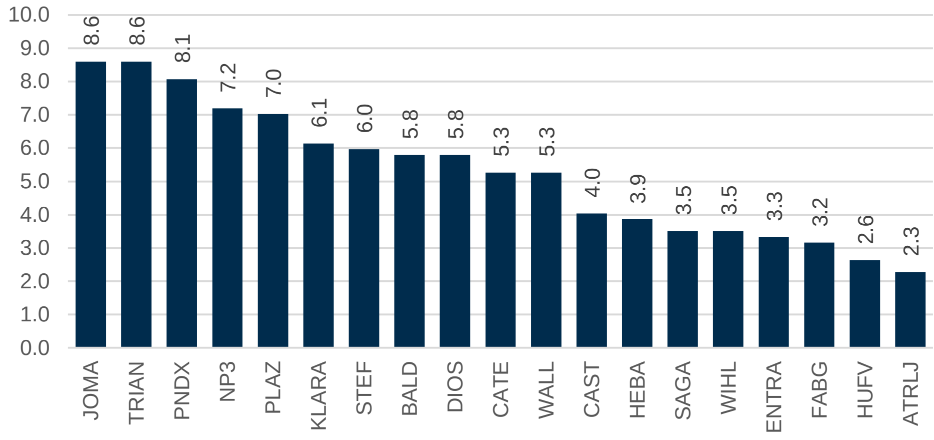
Table 19: ICR (x), current (left-hand chart) and at 200bp higher funding cost (right-hand chart)



Source: Handelsbanken Capital Markets

In an effort to exercise comparability on risks between the individual companies on debt and capital structure we have created a ranking system which encompasses multiple factors; near-term maturity of interest rate and debt (within 24 months), Net LTV, interest coverage ratio (ICR), and the yield gap between average yield requirements in their individual portfolios relative to their individual average paid interest rate. We believe that these factors when combined capture the near-term risk profile well of the companies on an aggregated basis. The graph below shows how the individual companies score in our ranking system (on a 1-10 basis), the higher the score – the higher the financial risk.

Figure 14: Ranking based on several factors



Source: Handelsbanken Capital Markets

In the screening process, there are two companies that stand out with John Mattson and Trianon receiving sub-par scores on all parameters. One factor that perhaps speaks to their advantage in the short term is that most of their debt is sourced from banks. On the other hand, both companies have low interest coverage ratios (ICR), which implies that they will struggle to amortise on debt rapidly in order to have a sustainable capital structure in a higher-interest-rate environment in the long term. Pandox also receive relatively 'bad' scoring, albeit its underlying market value suggests that the metrics should improve significantly in the coming quarters.

Large impact on cash generation from higher rates

The example calculation below displays the theoretical impact on a company if inflation is 3% and the paid interest rate increases from 1.6% to 2.4%. In addition, we also include what would happen if the required property yield increases in the simulation from 4.6% to 5.3%.

Table 20: Example calculation

		Base		Scenario coming 12m	vs. Base	
Rental income		**65.3**		**67.2**	**3.0%**	***<-- CPI adjustment 3.0%***
Operating costs	-	19.6	-	20.2	3.0%	*<-- Costs in-line w. CPI*
Net operating income		**45.7**		**47.1**	**3.0%**	
Net operating income margin		*70.0%*		*70.0%*	*0pp*	
Central administration	-	3.3	-	3.4	3.0%	*<-- Costs in-line w. CPI*
Financial costs	-	8.4	-	12.2	45.2%	
Income from property management		**34.0**		**31.5**	**-7.4%**	*<-- CPI not able to compensate for higher interest*
IFPM margin		*52.2%*		*46.9%*	*-5.3pp*	
Value changes		-	-	114.0		
Earnings before tax		34.0	-	82.4		
Tax paid	-	7.0	-	6.5		
Deferred tax		-		23.5		
Net income		27.0	-	65.5		
Net income adjusted		**27.0**		**25.0**	**-7.4%**	
Fair value of properties		**1 000**		**886**	**-11.4%**	*<-- CPI effect not able to compensate for higher yields*
Interest bearing debt		510		510	0.0%	
Equity		**420**		**355**	**-15.6%**	*<-- In-line with effect on NAV*
Yield		4.6%		5.3%	*0.7pp*	***<-- Assuming yield gap remains intact***
Paid interest rate		1.6%		2.4%	*0.7pp*	***<-- Spot financing terms w. 40% mauturing in <12 months***
Loan-to value (LTV)		**51.0%**		**57.6%**	***6.6pp***	<-- Covenant risk
Equity ratio		**42.0%**		**40.0%**	***-2pp***	<-- Covenant risk
ICR		**5.1x**		**3.6x**	**-29.0%**	<-- Covenant risk
Tax rate		20.6%		20.6%		

** Assumed sector average LTV, Equity ratio, valuation yield, debt maturity and paid interest rate*

Source: Handelsbanken Capital Markets

We assume that most of the rental income will see an increase in line with CPI (normally adjusted with the CPI for October, with full impact from 1 January the year after) and also that costs over time will follow underlying inflation. However, in a scenario where the funding cost increases on the back of higher bond spreads, STIBOR/EURIBOR and swap rates (real rates and/or inflation), the most important "input material" (borrowed capital) will increase to an extent at which it erodes a material part of the cash earnings generated by the property assets, including the increased rental income and NOI. In such a scenario, the imaginary company in the example above, all things being equal, will face a 7.4% IFPM decrease. In addition, the ICR will fall back to a much lower level, which could have an impact on ratings and funding costs.

If we assume that the required yield increases from 4.6% to 5.3%, primarily due to higher funding costs, property values will decrease by 11.4%, despite the positive impact from inflation. The rule of thumb suggests that, given gearing, the NRV decline will be almost double. In this scenario, we have not included the potential impact of deteriorating demand from tenants, in the event of a recession, with the accompanying potential impact on vacancies and market rents. These factors, alongside higher yield requirements, would have an additional impact on property values, from a flow perspective.

From massive growth to…. something else

Over recent years, cash earnings growth and property value growth have been massive among real estate companies in general, with a few exceptions. Falling interest rates and lots of liquidity in the capital markets have fuelled value growth and the volume of available funding. In a scenario where funding becomes more expensive and value growth tapers, or even becomes negative, acquisition-driven earnings growth will come to an end. This means that the valuation of property companies should change from earnings growth to no earnings growth, or negative growth.

A few companies seem to be better exposed to the new sentiment. For example, Sagax with its high-yielding assets, generating a large volume of cash flow for continued expansion, could be a relative winner.

Alongside the difficulties of maintaining acquisition-driven growth, organic growth through construction may also be an issue given the current conditions regarding new constructions and renovations. Elevated costs for raw materials, and a lack of important components and input materials, would not only lead to higher costs, making new construction projects too expensive to execute, but also make it impossible to start new projects.

Table 21: Construction cost increase sensitivity – simulation

		Cost inflation (building materials)								
	Base	**+10%**	**+15%**	**+20%**	**+25%**	**+30%**	**+35%**	**+40%**	**+45%**	**+50%**
Office/Residential projects										
Net operating income	40	40	40	40	40	40	40	40	40	40
Project cost	1,000	1,050	1,075	1,100	1,125	1,150	1,175	1,200	1,225	1,250
of which materials	*500*	550	575	600	625	650	675	700	725	750
Yield on cost (YOC), %	**4.0%**	**3.8%**	**3.7%**	**3.6%**	**3.6%**	**3.5%**	**3.4%**	**3.3%**	**3.3%**	**3.2%**
Yield on completion, %	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
Project margin, %	**14.3%**	**8.8%**	**6.3%**	**3.9%**	**1.6%**	**-0.6%**	**-2.7%**	**-4.8%**	**-6.7%**	**-8.6%**
Industrial/logistics projects										
Net operating income	60	60	60	60	60	60	60	60	60	60
Project cost	1,000	1,050	1,075	1,100	1,125	1,150	1,175	1,200	1,225	1,250
of which materials	*500*	550	575	600	625	650	675	700	725	750
Yield on cost (YOC), %	**6.0%**	**5.7%**	**5.6%**	**5.5%**	**5.3%**	**5.2%**	**5.1%**	**5.0%**	**4.9%**	**4.8%**
Yield on completion, %	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Project margin, %	**20.0%**	**14.3%**	**11.6%**	**9.1%**	**6.7%**	**4.3%**	**2.1%**	**0.0%**	**-2.0%**	**-4.0%**

Source: Handelsbanken Capital Markets

We expect the new construction of residential properties to be the most demanding in a high-cost situation with continued lack of critical materials. The owners of these property classes and projects do not have any pricing power, i.e. regulated rents for rentals means that it is impossible to increase rents to compensate for the higher cost (above CPI). And for co-op developers, the market price for the products, with high dependency of the pricing in the market for secondary apartments/houses, sets the output price.

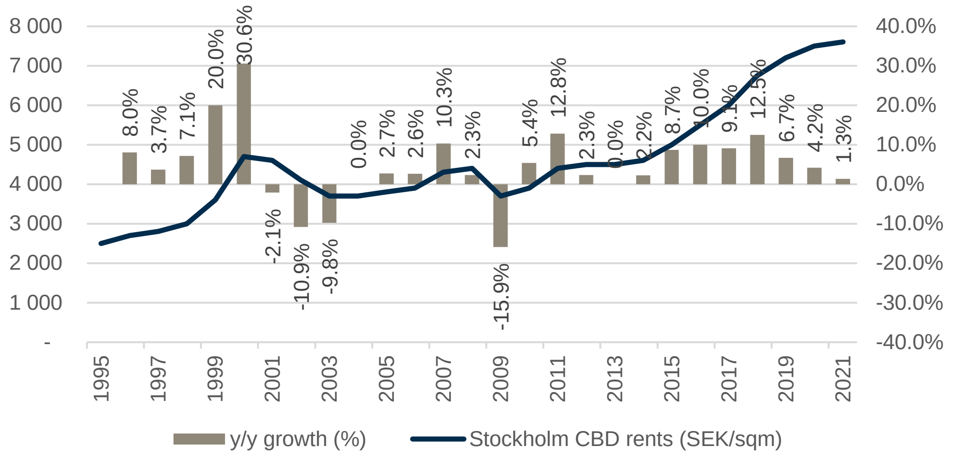
Commercial property developments would also be much more difficult to run on a healthy budget, given building rights at low book value and a previous large spread between yield on cost and property yield. However, it may be possible to find opportunities to build new properties with a smaller/no profit but with the possibility of driving organic growth of cash earnings on the back of completed developments.

Office rents at risk as vacancies go up?

Prime office rents in Stockholm have experienced an historically long period of solid rental growth extending between 2015 and 2019, with an average annual rental growth of 9.4%, due to contracting vacancy rates. Since the inception of the pandemic, however, vacancy rates have increased drastically and are now between the levels recorded during the financial crisis and the Dot-com bubble, while rentals have continued to grow, albeit at a slower pace. The question now is perhaps how long the oligopoly-style strategy of the stakeholders of the office stock can withstand higher vacancy rates before coming to terms with declining market rents.

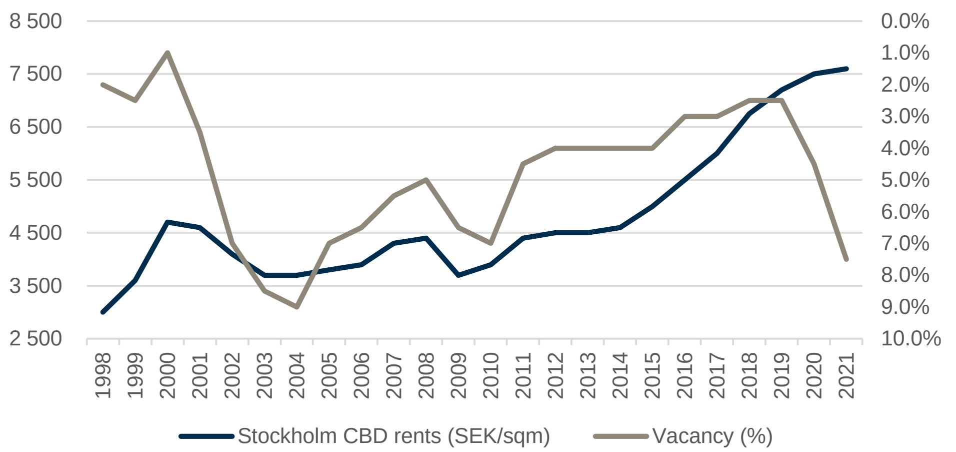
The aforementioned crises resulted in prime market rents coming down by 16% and 21%, respectively. In our view, something similar is likely to recur in the coming years, which is an additional risk to the earnings profiles of real estate companies focused on the office segment.

Figure 15: Office rental growth, Stockholm CBD



Source: Handelsbanken Capital Markets, Hufvudstaden

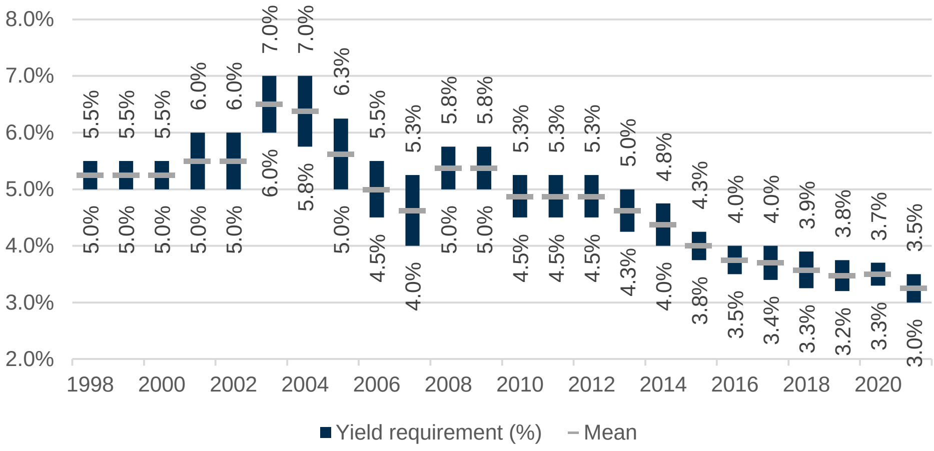
Figure 16: Prime office rent and vacancy rate, Stockholm CBD



Source: Handelsbanken Capital Markets, Hufvudstaden

In tune with recent years' rental growth, yield requirements/transaction yields in Stockholm CBD have also contracted significantly, in our view further boosted by lower financing costs, currently posting record low yields in the range of 3.0-3.5%, since 2014, the prime yield has contracted by 1.1 percentage points or 35% in relative terms. Since 2018, the corresponding numbers amount to 0.3 percentage points and 10% in relative terms. Interestingly, yield requirements have continued to contract despite what seems to be a tougher market outlook. During the financial crisis and the Dot-com bubble, yields expanded by 0.8 and 1.3 percentage points, respectively, or 14% and 19% in relative terms. In our view, this speaks to value deterioration on a standalone basis, which adds to the underlying property value risk for the segment.

Figure 17: Prime office yields, Stockholm CBD



Source: Handelsbanken Capital Markets, Hufvudstaden

Valuation and performance

Table 22: Valuation

Handelsbanken Capital Markets

Peer table: Real Estate (13 Apr 2022 15:15)

		Rec.				P/EPRA NRV				Adj. P/E			Dividend yield			Implied TR	Share performance			
Company	Segment	ST	LT	Target Price	Potential	Spot	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e	CAGR 2021-24e	1M	3M	6M	1Y
Atrium Ljungberg	Office	Hold	MP	250	35.4%	75%	71%	66%	64%	19.9x	17.8x	16.7x	2.9%	3.1%	3.3%	9.3%	-2.7%	2.4%	-1.9%	11.5%
Balder	Residential	Sell	MP	725	27.5%	113%	103%	96%	92%	19.5x	19.7x	19.6x	-	-	-	6.4%	-3.8%	-3.9%	2.3%	21.8%
Castellum	Office	Hold	MP	300	37.6%	87%	83%	80%	78%	16.4x	15.2x	14.0x	3.7%	3.9%	4.1%	7.9%	-1.3%	-1.5%	-0.4%	9.0%
Catena	Industrial	Hold	MP	710	32.3%	166%	147%	140%	131%	25.5x	23.6x	22.7x	1.7%	1.8%	1.9%	6.6%	5.9%	-0.2%	10.7%	36.8%
Diös	Office	Sell	UP	105	11.2%	97%	92%	89%	86%	12.9x	12.9x	13.7x	3.7%	3.8%	3.9%	7.5%	-4.7%	-13.5%	5.6%	28.7%
Entra	Office	Hold	MP	240	35.1%	81%	76%	74%	72%	19.7x	18.7x	16.9x	3.4%	3.5%	3.5%	8.4%	-3.5%	-6.6%	-8.4%	-5.8%
Fabege	Office	Hold	OP	205	59.0%	76%	73%	71%	69%	26.4x	25.4x	25.0x	3.3%	3.4%	3.5%	7.2%	-9.8%	-7.9%	-7.7%	2.1%
Heba	Residential	Sell	UP	180	16.9%	138%	126%	112%	107%	49.9x	37.9x	33.5x	1.1%	1.2%	1.2%	7.7%	7.2%	5.8%	14.8%	36.1%
Hufvudstaden	Office/Retail	Hold	MP	165	24.3%	67%	65%	62%	61%	26.1x	25.3x	24.7x	2.0%	2.1%	2.1%	6.7%	5.5%	1.7%	-0.7%	1.3%
John Mattson	Residential	Sell	UP	180	12.4%	84%	87%	84%	80%	38.4x	37.5x	38.3x	-	-	-	4.5%	-1.0%	-12.5%	-4.5%	13.8%
Klarabo	Residential	Hold	MP	44	36.3%	95%	83%	73%	64%	29.0x	23.7x	20.1x	-	-	-	14.8%	-11.3%	-27.9%		
NP3	Industrial	Sell	MP	380	28.6%	249%	215%	189%	168%	23.9x	20.8x	19.0x	1.8%	2.0%	2.3%	7.9%	-6.5%	-5.9%	19.8%	101.8%
Pandox	Hotel	Hold	MP	170	23.9%	79%	75%	71%	68%	15.5x	12.2x	11.5x	-	2.2%	2.2%	7.5%	4.7%	-2.1%	-3.7%	-14.0%
Platzer	Office	Sell	MP	150	39.9%	98%	86%	80%	76%	17.7x	15.4x	14.8x	2.3%	2.6%	2.8%	11.2%	3.5%	-14.9%	-18.7%	0.0%
Trianon	Residential	Sell	MP	250	28.3%	135%	125%	119%	113%	31.2x	27.5x	23.2x	1.4%	1.8%	2.1%	6.2%	0.2%	-14.2%	-4.5%	42.9%
Wallenstam	Residential	Hold	MP	170	35.0%	109%	106%	103%	99%	31.9x	35.7x	34.3x	1.3%	1.6%	1.7%	5.0%	-8.4%	-16.9%	-7.8%	-0.3%
Sagax	Industrial	Hold	MP	320	21.7%	269%	241%	216%	195%	29.1x	24.9x	22.2x	1.0%	1.1%	1.3%	5.5%	1.3%	-3.6%	-9.4%	29.3%
Stendörren	Industrial	Hold	MP	360	36.9%	141%	121%	109%	97%	28.5x	22.2x	19.7x	-	-	-	9.6%	7.3%	-9.6%	10.3%	62.5%
Wihlborgs	Office	Sell	UP	210	12.7%	108%	103%	99%	96%	16.1x	15.5x	15.5x	3.1%	3.2%	3.2%	6.7%	-3.7%	-2.3%	0.8%	6.0%
Mean					**29.2%**	**119%**	**109%**	**102%**	**95%**	**25.1x**	**22.7x**	**21.3x**	**2.3%**	**2.5%**	**2.6%**	**7.7%**	**-1.1%**	**-7.0%**	**-0.2%**	**21.3%**
Median					**28.6%**	**98%**	**92%**	**89%**	**86%**	**25.5x**	**22.2x**	**19.7x**	**2.2%**	**2.2%**	**2.3%**	**7.5%**	**-1.3%**	**-5.9%**	**-1.3%**	**12.6%**
Min					**11.2%**	**67%**	**65%**	**62%**	**61%**	**12.9x**	**12.2x**	**11.5x**	**1.0%**	**1.1%**	**1.2%**	**4.5%**	**-11.3%**	**-27.9%**	**-18.7%**	**-14.0%**
Max					**59.0%**	**269%**	**241%**	**216%**	**195%**	**49.9x**	**37.9x**	**38.3x**	**3.7%**	**3.9%**	**4.1%**	**14.8%**	**7.3%**	**5.8%**	**19.8%**	**101.8%**

Source: Handelsbanken Capital Markets

Table 23: Share performance

Handelsbanken Capital Markets

Share performance: Real Estate (13 Apr 2022 15:15)

			Share performance									Price (SEK)				Volume	
Company	Segment	Rec.	Intraday	1W	1M	3M	6M	1Y	2Y	3Y	5Y	Last	Ask	Bid	Spread	30D trend*	ADT 30D**
Atrium Ljungberg	Office	Hold	-2.02%	-4.7%	-2.7%	2.4%	-1.9%	11.5%	20.8%	21.3%	54.5%	184.6	184.7	184.4	16 bp		25.7
Balder	Residential	Sell	-1.80%	-9.7%	-3.8%	-3.9%	2.3%	21.8%	49.7%	93.3%	185.8%	568.8	569.2	568.8	7 bp		146.6
Castellum	Office	Hold	-1.54%	-9.6%	-1.3%	-1.5%	-0.4%	9.0%	34.9%	34.8%	113.4%	218.0	218.0	217.8	9 bp		259.5
Catena	Industrial	Hold	0.28%	-8.4%	5.9%	-0.2%	10.7%	36.8%	84.0%	125.2%	356.7%	536.5	536.5	535.5	19 bp		33.5
Diös	Office	Sell	-0.95%	-6.8%	-4.7%	-13.5%	5.6%	28.7%	59.7%	39.0%	157.3%	94.4	94.4	94.3	11 bp		25.5
Entra	Office	Hold	0.91%	0.3%	-3.5%	-6.6%	-8.4%	-5.8%	47.4%	50.8%	120.5%	177.6	184.0	175.0	514 bp		50.4
Fabege	Office	Hold	-2.13%	-6.5%	-9.8%	-7.9%	-7.7%	2.1%	7.2%	2.8%	91.7%	129.0	129.1	129.0	12 bp		70.6
Heba	Residential	Sell	-0.90%	-2.3%	7.2%	5.8%	14.8%	36.1%	89.3%	117.3%	193.7%	154.0	154.2	153.6	39 bp		3.9
Hufvudstaden	Office/Retail	Hold	-0.60%	-0.1%	5.5%	1.7%	-0.7%	1.3%	0.9%	-11.4%	9.1%	132.7	132.8	132.6	15 bp		60.2
John Mattson	Residential	Sell	-0.50%	-4.3%	-1.0%	-12.5%	-4.5%	13.8%	25.2%			160.2	160.2	159.6	38 bp		7.4
KlaraBo	Office	Hold	-0.68%	-5.3%	-11.3%	-27.9%						32.3	32.3	32.1	44 bp		3.4
NP3	Industrial	Sell	2.60%	-8.1%	-6.5%	-5.9%	19.8%	101.8%	285.5%	338.0%	626.6%	295.5	296.0	295.0	34 bp		55.5
Pandox	Hotel	Hold	-0.44%	-3.4%	4.7%	-2.1%	-3.7%	-14.0%	40.9%	-17.8%	0.3%	137.2	137.2	137.0	15 bp		25.2
Platzer	Office	Sell	-2.01%	-6.6%	3.5%	-14.9%	-18.7%	0.0%	53.9%	43.9%	173.1%	107.2	107.2	106.4	75 bp		27.6
Trianon	Residential	Sell	-0.92%	-9.6%	0.2%	-14.2%	-4.5%	42.9%	119.1%	166.9%		194.8	195.0	194.0	52 bp		4.7
Wallenstam	Residential	Hold	-1.95%	-9.2%	-8.4%	-16.9%	-7.8%	-0.3%	22.0%	38.5%	83.0%	125.9	125.9	125.7	16 bp		36.6
Sagax	Industrial	Hold	-0.75%	-7.7%	1.3%	-3.6%	-9.4%	29.3%	149.3%	214.7%	520.9%	263.0	263.2	262.9	11 bp		87.1
Stendörren	Industrial	Hold	-0.38%	-3.5%	7.3%	-9.6%	10.3%	62.5%	168.9%	117.4%	322.6%	263.0	264.5	263.0	57 bp		11.9
Wihlborgs	Office	Sell	-1.53%	-7.9%	-3.7%	-2.3%	0.8%	6.0%	39.1%	56.2%	142.2%	186.4	186.6	186.3	16 bp		46.6
Mean			**-0.80%**	**-6.0%**	**-1.1%**	**-7.0%**	**-0.2%**	**21.3%**	**72.1%**	**84.2%**	**197.0%**				**53 bp**	**8.6%**	**51.7**
Median			**-0.90%**	**-6.6%**	**-1.3%**	**-5.9%**	**-1.3%**	**12.6%**	**48.5%**	**50.8%**	**149.7%**				**16 bp**	**7.3%**	**33.5**
Min			**-2.13%**	**-9.7%**	**-11.3%**	**-27.9%**	**-18.7%**	**-14.0%**	**0.9%**	**-17.8%**	**0.3%**				**7 bp**	**-32.0%**	**3.4**
Max			**2.60%**	**0.3%**	**7.3%**	**5.8%**	**19.8%**	**101.8%**	**285.5%**	**338.0%**	**626.6%**				**514 bp**	**64.0%**	**259.5**

** Turnover in volume of shares traded the last 30 days compared to the prior 30 day period*

*** Average daily turnover in the last 30 days in SEK millions*

Source: Handelsbanken Capital Markets

Disclaimers

Recommendation structure and allocations

Handelsbanken Capital Markets Equity Research (HCM) employs a four-graded recommendation scale. The recommendations reflect the analyst's assessment of how much the share price may appreciate or depreciate in absolute terms in a 12-month time horizon and takes into account risks related to both fundamental expectations and share performance. This assessment is not based on a proprietary HCM model and the basis for the analyst's assessment is dependent on the characteristics of the sector and the company and a multitude of fundamental and timing factors are incorporated. For more detailed information about the recommendation structure please consult the Handelsbanken Capital Markets website: https://www.researchonline.se/desc/recstruct. **Investment ratings are determined by the ranges described in the table below.** The recommendations do not represent the analyst's or the bank's assessment of the company's fundamental value or quality. The recommendations and absolute performance intervals, together with the allocation of the rating categories amongst companies under coverage and amongst companies under coverage for which Handelsbanken has provided investment banking services in the past 12 months are listed below:

Ratings: definitions and allocations

HCM short-term rating (3 months)	Return expected to be[1]	HCM Universe[2]	IB services[3]
Buy	above 5%	44%	6%
Hold	between 0% and 5%	50%	22%
Sell	below 0%	6%	10%

[1] Return expected to be is defined as the expected share price appreciation or depreciation including dividends over the next three months
[2] Percentage of companies under coverage within each recommendation
[3] Percentage of companies within each recommendation for which investment banking services have been provided in the past 12 months

Ratings: definitions and allocations

HCM long-term rating (3 years)	R_{TP} is expected to be[4]	HCM Universe[5]	IB services[6]
Outperform	above 40%	47%	11%
Market Perform	between 20% and 40%	45%	17%
Underperform	below 20%	9%	20%

[4] R_{TP} is defined as the expected share price appreciation or depreciation including dividends over the next three years
[5] Percentage of companies under coverage within each recommendation
[6] Percentage of companies within each recommendation for which investment banking services have been provided in the past 12 months

Source: Handelsbanken Capital Markets, as per 19/4 2022

Recommendations are continuously reviewed by the analyst and monitored by the Research Management and will be updated and/or refreshed regularly. The rationale behind a change in recommendation will be explained in such a refresher/update.

A list of all recommendations made by investment research during the preceding 12-month period is available here: https://www.researchonline.se/desc/rechist.

The target price (TP) is the analyst's assessment of the level at which the share should be traded in a 12-month period. The TP is used as a basis for the recommendation (see explanation above) and takes into account timing-related issues and triggers, such as relative valuation and newsflow. The TP does not represent the analyst's or the bank's assessment of the company's fundamental value or quality.

Unless otherwise specified, share prices mentioned in this report refer to the closing price of the previous day.

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All share prices used in this report are as of 2022-04-13 at 15:15.

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The short-term recommendation Hold was set on 2022-03-11 as the first short-term recommendation for the company at the share price of SEK 190.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 190.

Balder
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 568.8.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 577.

Castellum
The short-term recommendation Hold was set on 2022-04-19 at a share price of SEK 217.90.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 215.

Catena
The short-term recommendation Hold was set on 2022-04-19 at a share price of SEK 536.50.
The long-term recommendation Market Perform was set on 2022-04-19 at a share price of SEK 536.50.

Diös
The short-term recommendation Sell was set on 2022-03-11 as the first short-term recommendation for the company at the share price of SEK 97.65.
The long-term recommendation Underperform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 97.65.

Entra
The short-term recommendation Hold was set on 2022-03-11 as the first short-term recommendation for the company at the share price of NOK 182.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of NOK 182.
Fabege
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 128.95.
The long-term recommendation Outperform was set on 2022-03-11 at a share price of SEK 139.65.

Heba
The short-term recommendation Sell was set on 2022-04-19 as the first short-term recommendation for the company at the share price of SEK 138.
The long-term recommendation Underperform was set on 2022-04-19 as the first long-term recommendation for the company at the share price of SEK 138.

Hufvudstaden
The short-term recommendation Hold was set on 2022-03-11 as the first short-term recommendation for the company at the share price of SEK 125.
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John Mattson Fastighets AB
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 160.20.
The long-term recommendation Underperform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 156.

KlaraBo
The short-term recommendation Hold was set on 2022-03-11 as the first short-term recommendation for the company at the share price of SEK 35.60.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 35.60.

NP3
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 295.50.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 304.

Pandox
The short-term recommendation Hold was set on 2022-04-19 at a share price of SEK 137.10.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 127.

Platzer
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 107.2.
The long-term recommendation Market Perform was set on 2022-04-19 at a share price of SEK 107.20.

Sagax
The short-term recommendation Hold was set on 2022-03-11 as the first short-term recommendation for the company at the share price of SEK 260.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 260.

Stendörren Fastigheter
The short-term recommendation Hold was set on 2022-04-19 at a share price of SEK 263.
The long-term recommendation Market Perform was set on 2022-04-19 at a share price of SEK 263.

Trianon
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 194.8.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 193.

Wallenstam
The short-term recommendation Hold was set on 2022-03-11 as the first short-term recommendation for the company at the share price of SEK 134.
The long-term recommendation Market Perform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 134.

Wihlborgs
The short-term recommendation Sell was set on 2022-04-19 at a share price of SEK 186.40.
The long-term recommendation Underperform was set on 2022-03-11 as the first long-term recommendation for the company at the share price of SEK 187.

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