Financing

Owning and managing real estate is a capital-intensive business, which requires readily accessible funding. Funding can be carried out utilizing shareholder equity as well as borrowed capital, and the look of a company's capital structure depends on the financial risk that the company and its owners are prepared to take.

Financing

The chosen capital structure is pivotal for the financial returns and risk exposure anticipated by owners. Among the factors that affect the choice are business risk and tax shield, as well as the risks and costs associated with increased borrowing. As early as the IPO (Initial Public Offering), Castellum established that the company would stand for low financial risk – which is currently expressed in terms of a loan-to-value ratio not permanently exceeding 55% and an interest coverage ratio of at least 200%.

As of December 31, Castellum's assets amounted to SEK 84 billion and the loan-to-value ratio was 47%, while the interest coverage ratio for 2017 was 386%.

Finance policy and monitoring

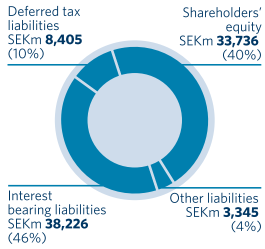
Castellum's financial activities are conducted in accordance with the finance policy established by the Board. These will be conducted in such a way that fulfilling the need for long- and short-term financing and liquidity is ensured. Moreover, low and stable net interest costs will be pursued while taking into account the established risk mandates. Developments in financial markets have a great impact on Castellum. For finance operation purposes, it is therefore important to reflect and support the goals and requirements of the business operations. With the support of the finance policy, the Group can control and manage financial risks and ensure risk management through close control and monitoring. The financial risks are monitored and reported quarterly to both the Audit and Finance Committee and the Board. The Board annually conducts a review of the finance policy.

Castellum regularly follows up and monitors future funding needs based on assumptions about earnings, net investment volume, property value growth and maturity profile of the existing debt portfolio, covenants in loan agreements and interest-rate risk exposure. Furthermore, the Group carries out sensitivity analyses to understand how changes in the real estate portfolio – as well as movements in market interest rates and property values – affect the balance sheet and earnings.

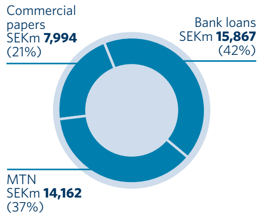
Financial strategy

Castellum's financing strategy shall support operations and manage the Group's financial risks while promoting an open and transparent climate. The strategy will be reflected in the finance policy established by the Board – all to ensure risk management through close control. Castellum's finance strategy can be summarized in five cornerstones: diversification, liquidity, strength, transparency and flexibility.

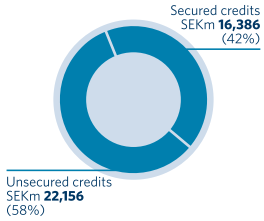
Financing
31-12-2017



Distribution of financing
31-12-2017



Secured credit facilities
31-12-2017



CASTELLUM'S FIVE CORNERSTONES ABOUT FUNDING

DIVERSIFICATON	Castellum will oversee a diversified loan portfolio and avoid dependence on both individual counterparty and source of financing. In addition, the maturity of various kinds of funding sources and individual loans will be distributed over time. Castellum will monitor and follow developments on financial markets, enabling us to act quickly and to match business requirements. At year end, Castellum's interest-bearing financing amounted to SEK 38.0 billion, of which SEK 22.2 billion came from capital market financing (an MTN-program totalling SEK 14.2 billion and a commercial paper program totalling SEK 8.0 billion) corresponding to 58%. Remaining financing came from bank financing from major Nordic banks and credit institutes. At year end, the average maturity of credit agreements amounted to 2.7 years and ranged from 1 month to 24.0 years.
LIQUIDITY	Castellum will keep unutilized credit facilities available, in order to respond rapidly to business needs and opportunities that arise. Moreover, there will be revolving credit facilities for the purpose of reducing the need to invest the surplus. At year end, Castellum had SEK 57.2 billion in credit agreements, of which SEK 19.2 billion was unutilized.
STRENGTH	The Group's financial key ratios will be strong, with a loan-to-value ratio not exceeding 55% and an interest coverage ratio of at least 200%. The strength of our real estate portfolio is enhanced by the quality of our cash flow as well as by the composition of our debt and interest rate portfolio. Castellum is to reduce the risk of sudden negative impact on net financial items – resulting from interest rate changes and/or the assessment of Castellum as borrower – that cannot be adjusted by opposing effects on income related to business operations. The loan-to-value ratio was 47% at year end, while the interest coverage ratio for 2017 was 386%.
TRANSPARENCY	Castellum will encourage long-term relationships with both banks and other lenders/investors and aim to be transparent in order to increase stakeholder understanding of the Group's operations and, consequently, credit exposure.
FLEXIBILITY	Castellum is to have flexible financing for the purpose of supporting business developments regarding acquisitions, sales and project development. Our credit facilities will provide us with high flexibility to withdraw and repay with short notice and at no extra cost. Furthermore, Castellum is to have access to flexibility, both in terms of pricing (fixed and floating) and maturities. At year end, Castellum had SEK 35.1 billion in bank agreements, of which SEK 24.9 billion consisted of revolving credit facilities.

Funding risk

Funding risk refers to the risk that financing is not available or is very unfavourable at a given time. Funding risk itself is by far the Group's largest financial risk. The Group's assets – primarily commercial properties – should be seen as long-term investments, which thereby comply with demands for a long-term approach to real-estate portfolio financing. However, market pricing of credit should also be taken into account.

Castellum should enjoy sufficient and competitive financing so the Group's activities can be conducted in an effective and cost-efficient manner. The funding risk is managed through advance planning, an appropriate credit maturity structure, balanced loan pricing, diversification of funding sources and maturities, and a reasonable liquidity cushion.

At year end, Castellum had credit agreements totalling SEKm 57,240 (53,259), of which long-term agreements amounted to SEKm 45,120 (40,358) and short-term contracts to SEKm 12,120 (12,901).

During 2017, credit agreements of SEKm 1,367 were terminated or expired while agreements totalling SEKm 12,915 were renegotiated. SEKm 370 of these were bank overdrafts. This means that guarantees decreased by a total of SEKm 4,804. In addition, loan agreements for EURm 75 were entered into with the European Investment Bank (EIB). Moreover, during the year, MTNs for SEKm 1,600 expired while SEKm 6,500 were newly issued.

After deduction of liquid assets of SEKm 203 (257), net interest-bearing liabilities were SEKm 38,023 (38,210), of which SEKm 14,162 (9,256) were outstanding MTNs and SEKm 7,994 (7,702) were outstanding commercial papers. Nominally SEKm 14,175 and SEKm 8,000 respectively.

Issued commitments in credit agreements – called covenants – state a loan-to-value ratio not exceeding 65% and an interest coverage ratio of at least 175%, which Castellum accomplished by a wide margin: 47% and 386%, respectively.

Average maturity of Castellum's credit agreements was 2.7 years (3.0).

Credit maturity structure 31-12-2017

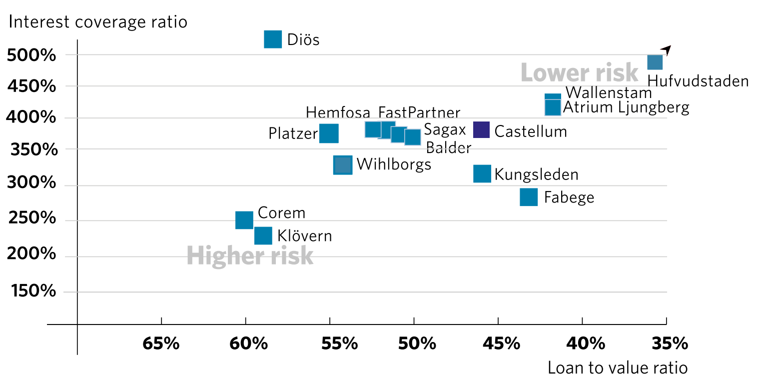
	Credit	Utilized in		
SEKm	agreement	Bank	MTN/Cert	Total
0–1 year	12,120	875	10,244	11,119
1–2 years	20,657	4,844	3,298	8,142
2–3 years	7,470	4,949	2,521	7,470
3–4 years	10,019	2,019	2,300	4,319
4–5 years	2,959	19	2,940	2,959
> 5 years	4,015	3,161	853	4,014
Total	**57,240**	**15,867**	**22,156**	**38,023**

Interest rate risk

By definition, interest rate risk refers to a potentially negative impact on the income statement and balance sheet caused by a change in market interest rates. To limit fluctuations in net interest costs, Castellum will feature a mix of fixed interest terms on loans and interest rate derivatives. However, as long as the Stibor rate (3 months) is negative, derivatives in the form of interest-rate swaps do not provide a stable cost structure for Castellum when combined with bank credits that have zero as the floor for the Stibor rate. Choice of interest-rate profiles should take into account the in the Group's Business Plan as well as anticipated inflows and outflows.

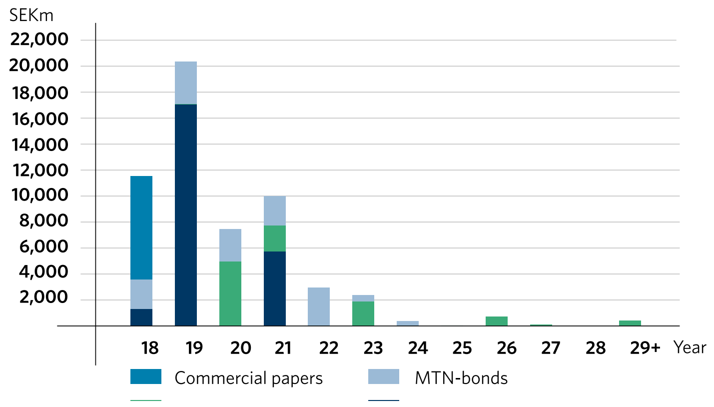
Interest cost is the single largest cost item and has a major impact on growth in income from property management. It is partly affected by changes in market interest rates, and partly by the margin

Listed real estate companies



Source: Rolling annual values based on each company's report Q3 report 2017.

Credit maturity structure



Bank-TL: Bank Term Loan
RCF-facility amounts: Revolving Credit Facility – facility amounts

required by creditors as compensation for lending money. The short-term market interest rate is controlled by the Riksbank, whereas the long-term market interest rate is affected by other factors such as expectations of future growth and inflation. The credit margin is controlled by supply-and-demand for credit, as well as by regulations in the credit and capital markets. Both interest and credit markets can change rapidly and are outside Castellum's control. Increased market interest rates are generally a result of economic growth and rising inflation. Higher rates, in turn, are presumed to result in increased demand for commercial premises, thereby leading to increased rents and/or reduced vacancies. Falling interest rates are assumed to have opposite causes and effects. Given this reasoning, rising or falling market interest rates will thus be met by rising or falling rental income, over time. Changes in credit margins may occur regardless of prevailing economic conditions. Recently, they have primarily been affected by changes in credit and capital market regulations. Changes in market interest rate and credit margins affect net financial items. How quickly – and by how much – largely depends on the chosen fixed interest term and the binding period of credit margins.

To ensure a low and stable net interest cost, Castellum has chosen to restrict the proportion of fixed maturities due within 6 months at an interval between 20% and 55% of net debt; the average fixed interest term will be between 1 and 3.5 years. The interest coverage ratio is the financial key ratio that describes a company's risk level and resilience to fluctuations in net interest.

Castellum's strategy is an interest coverage ratio of at least 200%. For 2017, the interest coverage ratio was 386% (348%). The average fixed interest term at December 31, 2017, was 2.4 years (2.4), while the share of maturities due within 6 months was 38%. Margins and fees on credit agreements had an average term to maturity of 2.2 years (2.4).

Net financial items for 2017 amounted to SEKm - 885 (- 832) with an average interest rate of 2.4% (2.4%), and included market interest rate at issue date plus creditors' margins. Average effective interest rate at December 31 2017 was 2.4% (2.6%).

In the table, credit margins and fees are distributed according to the reported maturity segments of the underlying credits, while credit fees and rate differences in MTNs are reported in the segment for 0–1 year.

47%

Loan to value ratio 2017

386%

Interest coverage ratio 2017

Interest maturity rate 31-12-2017

				Derivates				
	Credit, SEKm	Closing average interest rate	Volume fixed interest rate, SEKm	Closed fixed interest rate**	Volume variable interest rate, SEKm	Closing variable interest rate***	Closing interest rate	Average fixed interest rate term
0–1 year	31,128	1.1%*	1,750	2.0%	- 16,823	- 0.6%	2.8%	0.3 year
1–2 years	950	0.7%	2,100	1.7%	-	-	1.4%	1.7 years
2–3 years	1,598	1.4%	3,373	2.0%	-	-	1.8%	2.5 years
3–4 years	2,999	1.7%	2,800	1.9%	-	-	1.8%	3.4 years
4–5 years	1,148	2.1%	1,250	2.3%	-	-	2.2%	4.5 years
5–10 years	200	2.3%	5,550	3.0%	-	-	2.9%	7.0 years
Total	**38,023**	**1.1%**	**16,823**	**2.3%**	**- 16,823**	**- 0.6%**	**2.4%**	**2.4 years**

*Including credit-agreement fees and exchange rate differences for MTNs
** Castellum pays fixed interest rates
*** Castellum receives variable interest rates

Castellum's financial policy and commitments in credit agreements

Policy		Commitment	Outcome
Loan to value ratio	Not in the long run exceeding 55%	No more than 65%	47%
Interest coverage ratio	At least 200%	At least 175%	386%
Funding risk			
– average capital tied up	At least 2 years		2.7 years
– proportion maturing within 1 year	No more than 30% of outstanding loans and unutilized credit agreements		8%
– average maturing credit price	At least 1.5 years		2.2 years
– propotion capital market financing	No more than 75% of outstanding interest bearing liabilities		58%
– liquidity reserve*	Secured credit agreements corresponding to SEKm 750 and 4.5 months upcoming loan maturities		Fulfilled
Interest rate risk			
– average interest duration	1.0-3.5 years	–	2.4 years
– proportion maturing within 6 months	At least 20%, no more than 55%	–	38%
Credit and counterparty risk			
– rating restrictions	Credit institutions with high ratings, at least S&P BBB+		Fulfilled
Currency risk			
– translation exposure	Shareholders equity is not secured	–	Not secured
– transaction exposure	Handled if exceeding SEKm 25	–	Under SEKm 25

Credit and counterparty risk
Credit and counterparty risk is the risk that the counterparty cannot fulfil delivery or payment. In financial operations, credit and counterparty risk arises primarily in connection with long-term credit agreements, derivative contracts and the investment of liquid funds.

Castellum limits this risk by requiring high creditworthiness of counterparties; currently, all of them are major Nordic banks.

Currency risk
Currency risk refers to a negative impact on the income statement, balance sheet and cash flow due to changes in exchange rates. Currency risk can be divided into translation exposure and transaction exposure. At year end, Castellum owned properties in Denmark totalling SEKm 5,671 (5,395), which means that the Group is exposed to currency risk. Currency risk relates mainly to income statements and balance sheets in foreign currencies that are translated into Swedish kronor. As a basic rule, equity is not hedged for translation exposure, while transaction exposure is hedged if exposure in any currency exceeds a counter-value of SEKm 25.

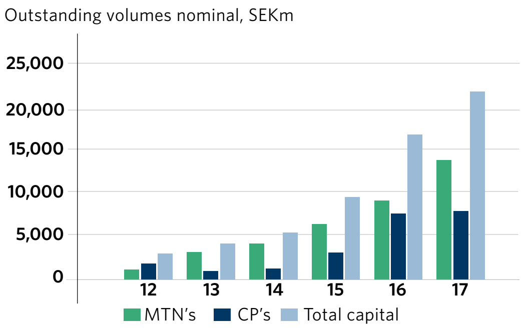
Secured interest-bearing liabilities
Long-term bank facilities are mainly secured with collateral comprising the company's real estate holdings, and commitments also include a number of covenants. Issued MTNs, commercial papers and certain short-term bank loans, such as overdraft credits, are unsecured. Of net interest-bearing liabilities totalling SEKm 38,023 (38,210), SEKm 15,867 (21,252) were secured by mortgage deeds and SEKm 22,156 (16,958) were unsecured. The proportion of utilized secured financing was thus approx. 20% of the property value. Issued commitments in credit agreements state a loan-to-value ratio not exceeding 65% and an interest coverage ratio of at least 175%. Castellum is also to provide lenders with financial information such as annual reports, interim reports and property valuations. In some cases, the banks have the right to renegotiate credit agreements due to a significant change in business direction or discontinued stock exchange listing.

Derivatives
Interest rate derivatives
According to the IAS 39 accounting standard, derivatives are subject to market valuation. For interest-rate derivatives, this means that a surplus or a deficit occurs if the stipulated interest rate varies from the current market rate. Castellum accounts for this change in value in the income statement. By extending the fixed interest term, the interest rate risk in terms of cash flow is limited, whereas the risk for accounting-based changes in value is increased. To note: loans with long-term, fixed interest rates are less flexible but – from an interest rate risk standpoint – comparable to extensions using interest-rate derivatives. These are not subject to market valuation according to current accounting standards.

Currency derivatives
Funding in Danish currency can be achieved by borrowing in Danish kroner or by using currency derivatives. The exposure is the same but derivatives are subject to market valuation, according to the IAS 39 accounting standard. This means that there is a surplus or a deficit if the stipulated currency rate varies from the current exchange rate. Castellum applies hedge accounting according to IAS 39, implying that the effective portion of value changes is accounted for in other total net income.

Organization
All financial risk management is centralized in the parent company. The internal bank is responsible for the Group's funding, risk management, financing for subsidiaries and cash management. The parent company also includes a back-office and compliance function, which provides accounting and independent control of financial operations.

Development of capital market financing 2012–2017



Updated list for MTN on www.castellum.com

Financial facilities

Credit/facility type	Frame/facility type	Utilized 31-12-2017
MTNs*	15,000	14,175
Certificates*	8,000	8,000
Bank credits incl. overdrafts	35,084	15,867

* Nominal volume

Secured borrowing

	31-12-2017
Proportion secured borrowing of total borrowings	42%
Proportion secured borrowing of property values	20%
Proportion secured borrowing of total assets	19%