

# Commercial real estate firms may need to reduce their debt



By: Ted Aranki and Tobias Cronbäck \*

## Summary

In this FI Analysis, we estimate how much Swedish listed and larger privately owned real estate firms need to reduce their debt to reach certain levels of interest coverage ratio and LTV. We have based our calculations on a scenario in which interest expenses continue to rise and property values fall. The commercial real estate firms' liabilities total approximately SEK 1,500 billion. Higher interest rates have increased the firms' financing costs. These, combined with a weaker economic outlook, have resulted in lower property values. This development increases the pressure on the interest coverage and LTV ratios, both of which are important indicators for assessing the creditworthiness of real estate firms.

Though some firms have started to make debt adjustments, this analysis shows that more firms need to reduce their debt to deal with a scenario in which interest expenses rise to 5 per cent and property values fall by 20 per cent. In total, a debt reduction of about SEK 100 billion, or on average 15 per cent per firm, is needed for each firm to avoid an interest coverage ratio below 1 and an LTV ratio above 70 per cent. It is not necessary to reach these exact threshold values, but firms often strive toward better financial indicators that can be seen as more sustainable in the long term. This would increase their need to further reduce debt. Our assessment shows that a greater debt reduction is needed to maintain the interest coverage ratio than to maintain the LTV ratio.

Firms can strengthen their financial position in various ways and over time. The analysis indicates that some firms need to issue equity or sell properties. Compared to issuing equity, selling properties requires about twice the amount to reach the same results. Many firms may need to sell a large portion of their property portfolio or raise capital by other means. However, more than half of the total need pertains to just a few firms. In the worst case, this means that there are concentration and contagion risks that can lead to a self-reinforcing process.

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28 november 2023, FI Ref. 23-29851

\* The author would like to give special thanks to Johan Berg, Henrik Braconier, Erika Goldkuhl, Lars Hörngren, Magnus Karlsson, Anders Kvist, Thomas Nielsen, Annika Otz, Stefan Palmqvist and Jenny Rolling.

The FI analyses have been presented at an internal seminar at FI. They are approved for publication by an editorial board.