



# High level view of the Real Estate market in Iceland

February 4<sup>th</sup> 2021

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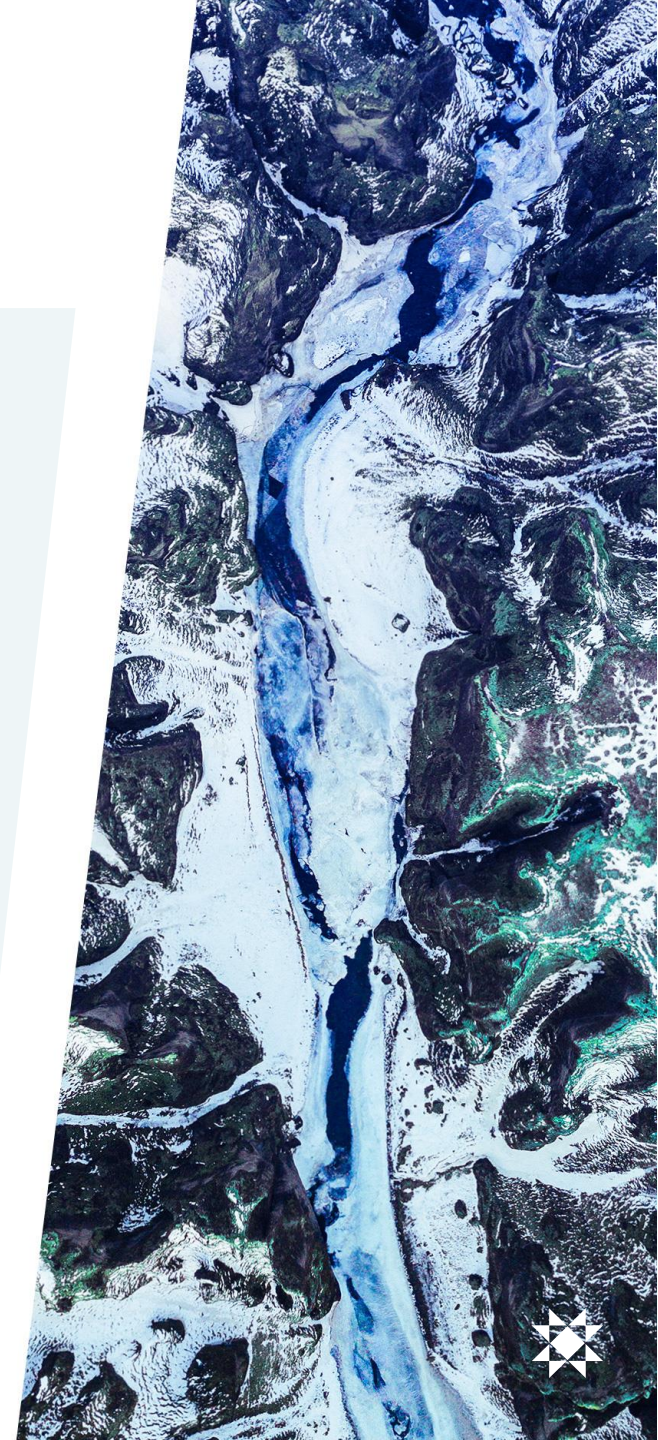
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1. Market characteristics/facts
2. Options of foreign investment entry
3. Macroeconomic environment
4. Arion Bank as a partner



# Market characteristics of the Icelandic Real Estate Market

Background facts to keep in mind

## Iceland snapshot

**368,000**  
Population (2019)



**\$23 bn. (3,000 bn. ISK)**  
GDP (2019)



**1.9%**  
GDP growth (2019)



**\$64,500 (8 m. ISK)**  
GDP per Capita (2019)



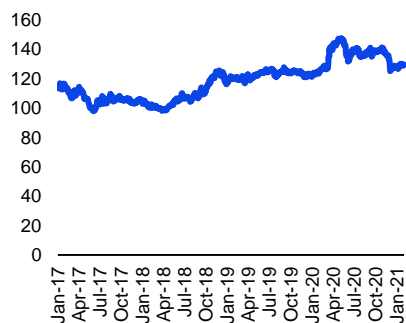
**#13**  
Economic Freedom  
(2020)



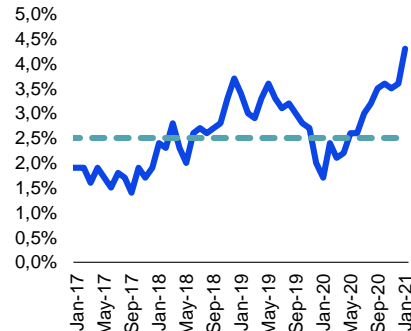
**#1**  
Gender Gap  
(2020)



USD/ISK



Inflation and inflation target



## Market characteristics and facts

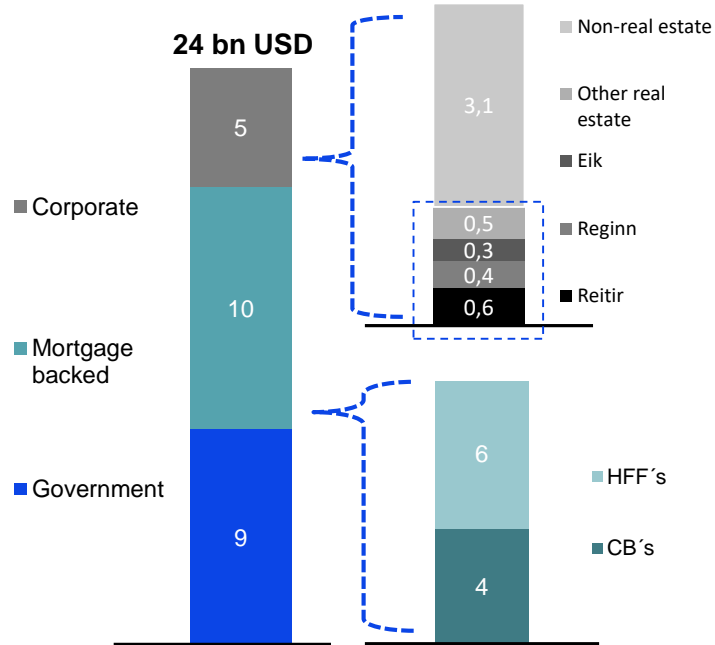
- Market size of commercial real estate estimated 12-13 million sq.meters (~135 million sq.foot)
- Residential market in Iceland is consist of ~145,000 apartments/houses
  - 85% of the population live in own apartments/houses and 15% are on the rental market
- Index linked
  - Loans and rental agreements indexed to the official consumer price index (CPI) have been a common product in Iceland since 1979.
  - CPI-linked mortgages are typically annuities, where the monthly payment and the remaining principal are linked to the CPI, where the inflation effect accumulates on top of the principal.
  - 60% of household mortgages are indexed and 40% non-indexed
- Residents and legal entities, domiciled outside EEA or EFTA are subjected to restrictions that would need to be considered early in the process
- Relatively low volumes compared to Scandinavia
- Icelandic krona - On global scale a small independent currency
- Covid-19 measures have been successful, and way of life is largely unaffected



# Real Estate exposure through listed market

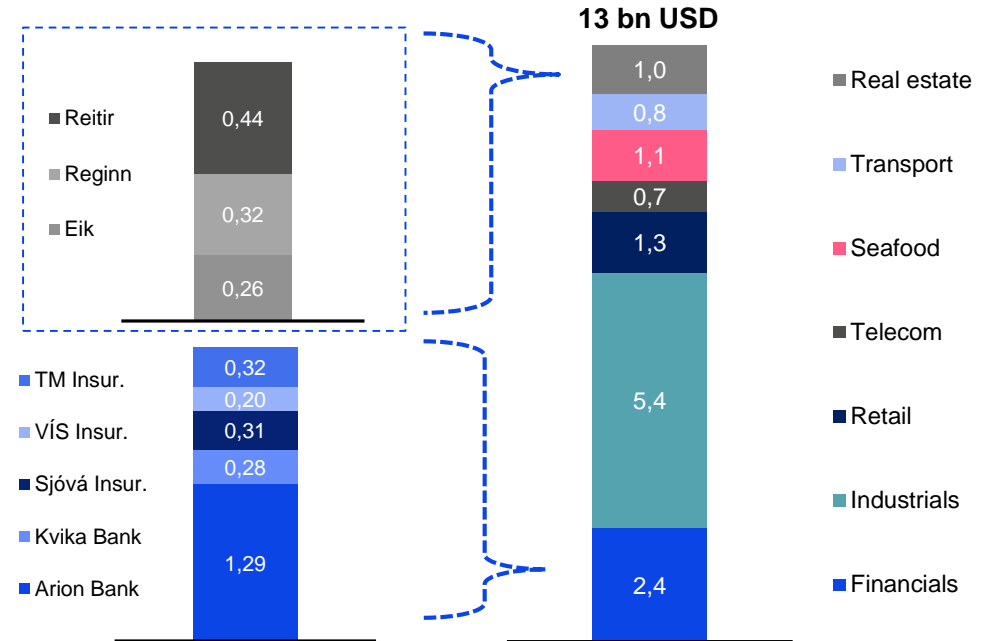
## The Icelandic listed bond and equity market

The bond market (Total size: 24 bn.USD)



- Debt markets amount to roughly 100% of GDP and is predominantly government or mortgage backed. Close to 50% of all issues are inflation protected
- Corporate bond issuance is firmly on the rise. A clear leader in domestic capital markets, Arion Bank embraces this trend

The equity market (Total size: 13 bn.USD)



- The equity market is around 50% of GDP, relatively smaller than in other Nordic countries
- The Icelandic equity market includes the largest local companies in retail, commercial real estate, telecom, insurance, transportation and tourism along with key seafood companies.
- Foreign ownership is predominantly in the two dually listed companies, Marel and Arion Bank.
- Mutual funds and investment companies have been gradually accumulating larger part of the market.

Pension funds manage a high share of private savings in Iceland. Domestic pension funds, are the single largest group of investors in both domestic debt and equities.

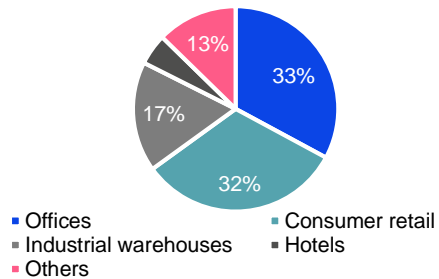


# Listed Commercial Real Estate Companies



<b>Assets</b>	375,000 sqm ~4 m.sq.feet
<b>Market Cap:</b>	\$300 m.
<b>NOI LTM<sup>1</sup>:</b>	\$50 m.
<b>Assets book value:</b>	\$1,0 bn.
<b>P/B:</b>	0.9x
<b>Yield:</b>	4.9%
<b>EV/sqm (sq.ft):</b>	\$2,500 (\$230)

Split of investment assets<sup>2</sup>



Share price development in ISK

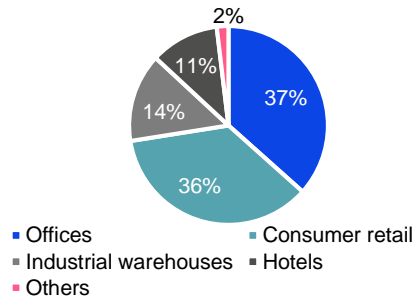


Company website: <https://www.reginn.is/en/>

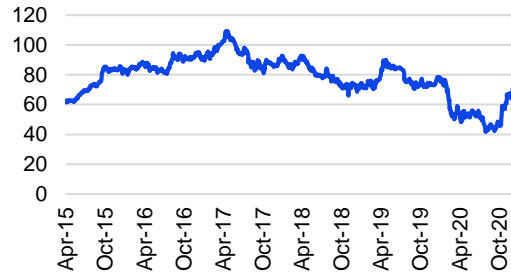


<b>Assets</b>	440,000 sqm ~5 m.sq.feet
<b>Market Cap:</b>	\$405 m.
<b>NOI LTM<sup>1</sup>:</b>	\$52 m.
<b>Assets book value:</b>	\$1,0 bn.
<b>P/B:</b>	1.0x
<b>Yield:</b>	4.9%
<b>EV/sqm (sq.ft):</b>	\$2,400 (\$220)

Split of investment assets<sup>3</sup>



Share price development in ISK

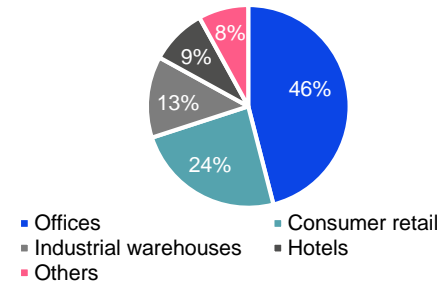


Company website: <https://www.reitir.is/en>



<b>Assets</b>	310,000 sqm ~3 m.sq.feet
<b>Market Cap:</b>	\$255 m.
<b>NOI LTM<sup>1</sup>:</b>	\$40 m.
<b>Assets book value:</b>	\$725 m.
<b>P/B:</b>	1.0x
<b>Yield:</b>	5.5%
<b>EV/sqm (sq.ft):</b>	\$2,300 (\$210)

Split of investment assets<sup>3</sup>



Share price development in ISK



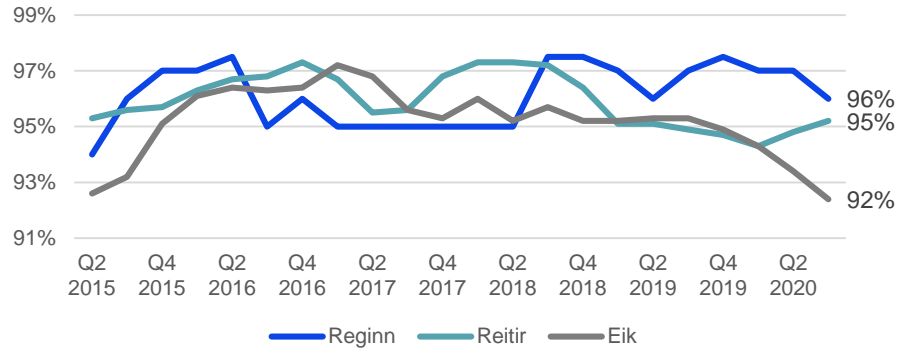
Company website: <https://www.eik.is>



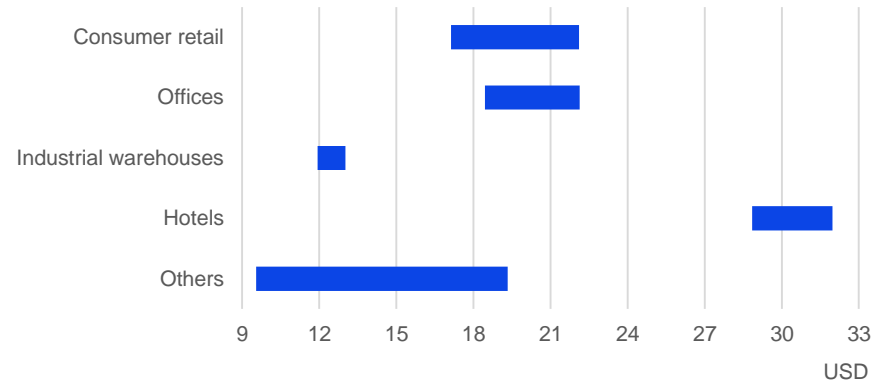
# Listed Commercial Real Estate Companies

Decent recovery expected post Covid

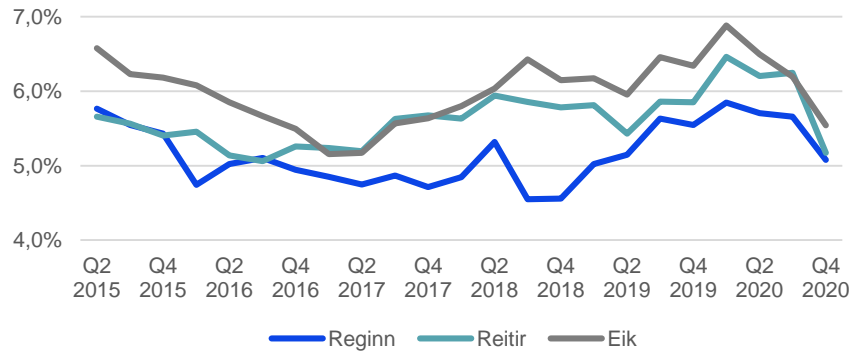
## Utilization rate



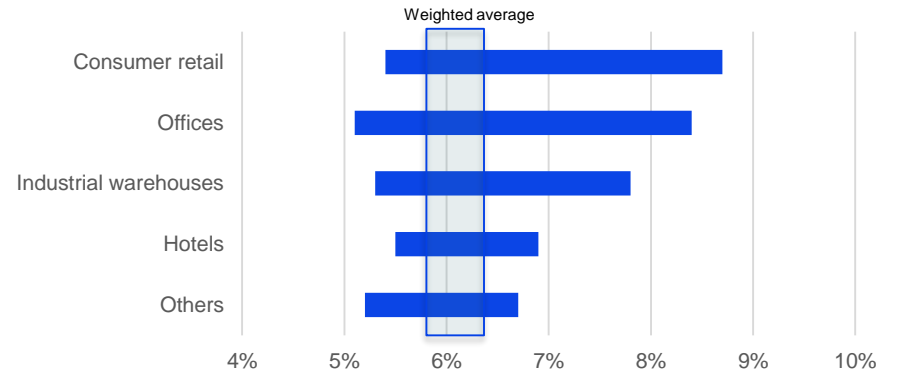
## Monthly rental income pr. sq.m. by real estate type (Reinn, Reitir & Eik)



## NOI Yield (EBITDA/EV)



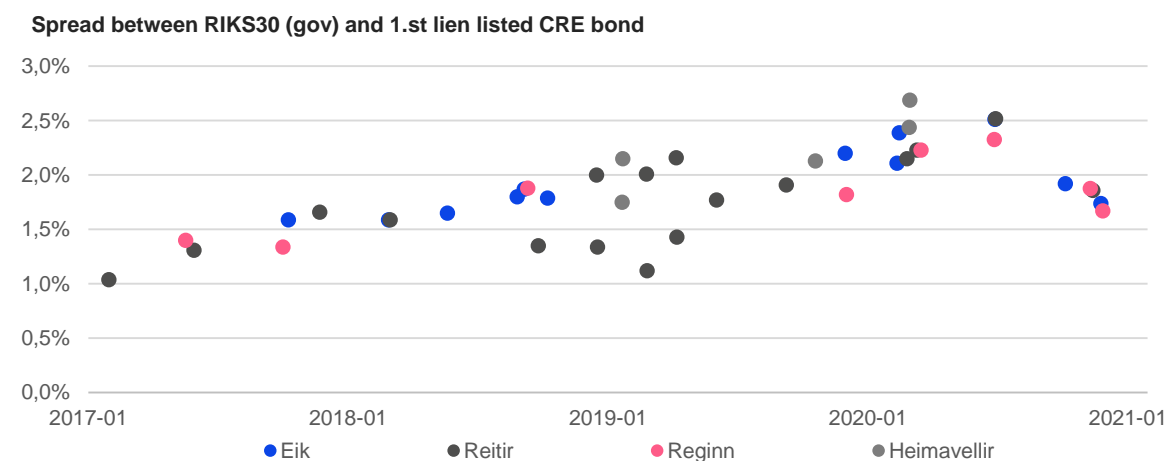
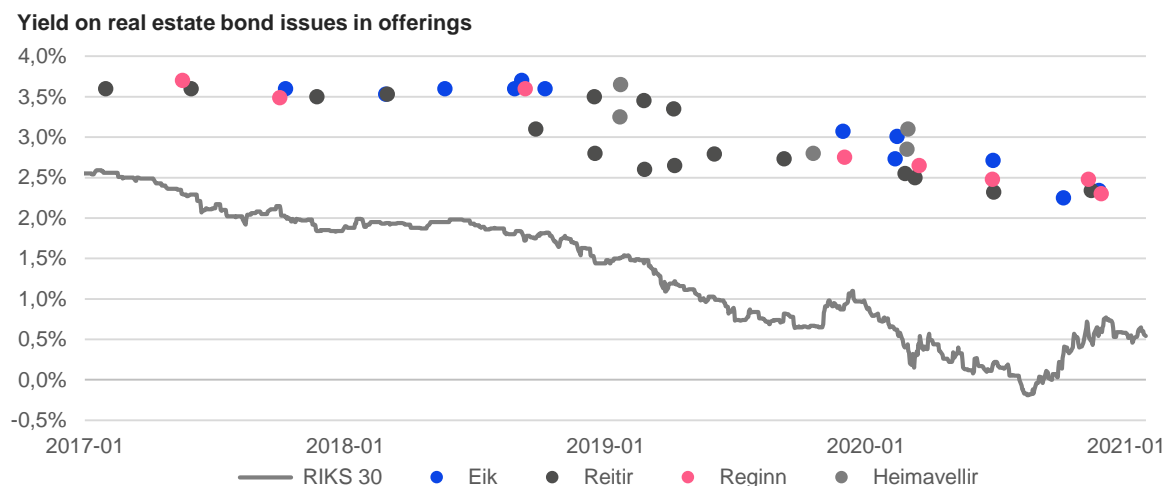
## WACC by real estate type (Reinn, Reitir & Eik)



# Listed Commercial Real Estate Companies

Bond issues - Yields have declined slowly as the spread has increased

- The latest bond issues of the Icelandic real estate companies issued for 10-30 years have been between 2.25-2.50% (indexed)
- The Central Bank's policy rate has never been lower and today stand at 0.75%
- Yields on long-term government bonds have fallen in recent years but bond issues have not followed to the same extent.
- The spread on corporate bonds have therefore risen substantially since 2016 but the yield has fallen to some extent, especially in recent months.



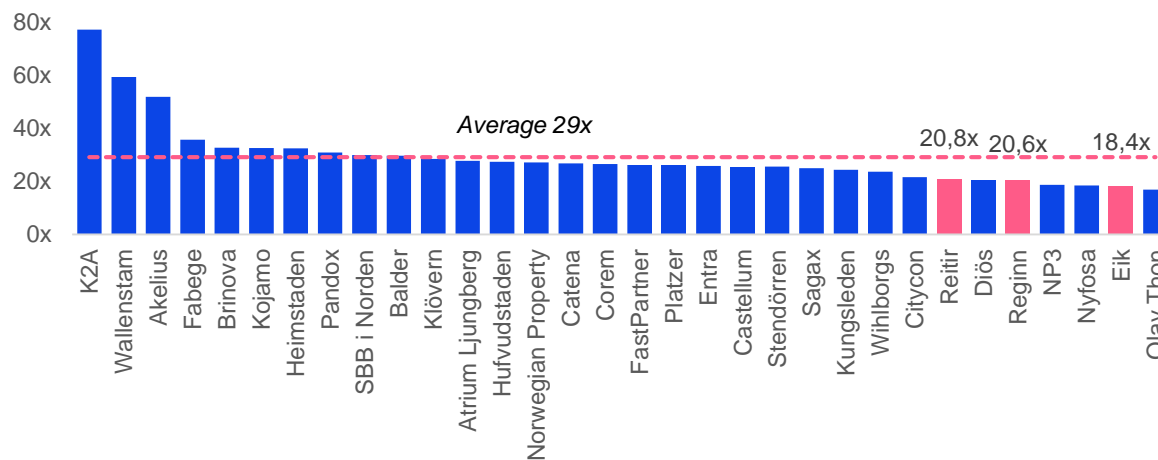


# Iceland's Commercial Real Estate Market Listed on Nasdaq OMX Iceland

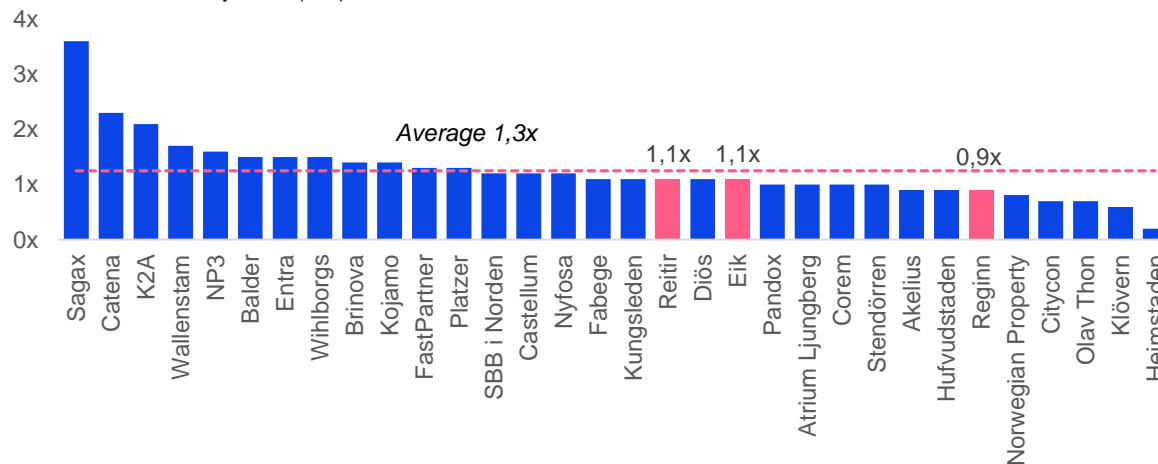
## Comparison with Nordic shares

- Nordic transaction volume has been roughly around 50 bn.USD annually in the last couple of years, Iceland still a minor part of total volume
- Listed Icelandic real estate companies trading well below the EV/EBIT multiple average of 29x.
  - Reitir and Eik closer to the market average when compared to Price to book
  - The three Icelandic have a higher debt ratio then it's Nordic peers.

Listed real estate companies (EV/EBIT)



Listed real estate companies (P/B)

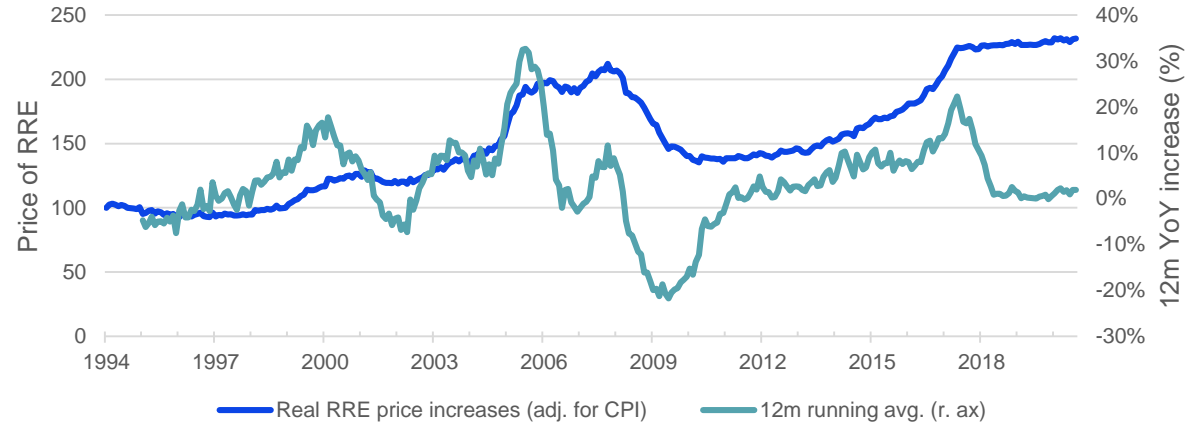


# Other alternatives - Further consolidation of the residential leasing market

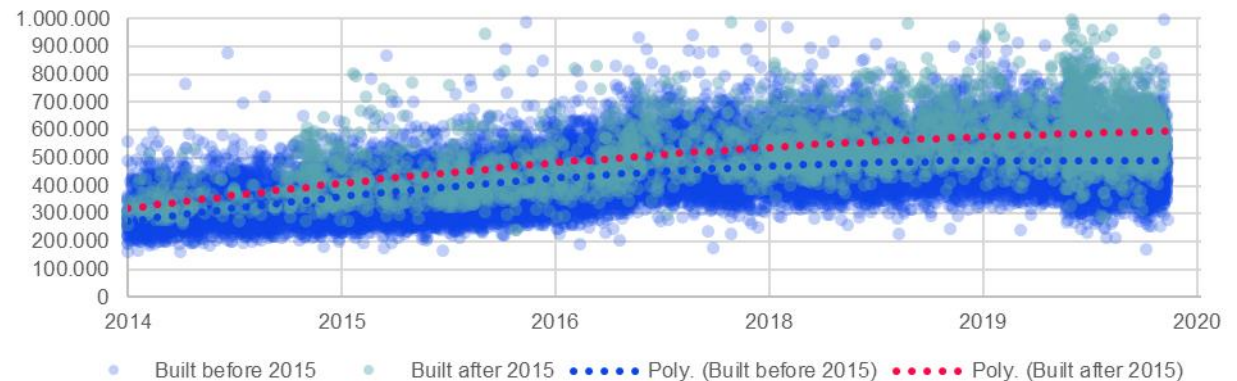
## Residential market

- Residential leasing, fragmented market
- The Norwegian based Heimstaden entered the market in 2020
- Real estate prices in the greater Reykjavik area have increased lately with September 2020 being a record month by agreements.
- Projected lack of supply in the market of 5,000 – 8,000 residential units.
  - The capital area accounts for approximately 70-80% of that figure.
- Despite slowing sales of newly built apartments in downtown Reykjavik there are multiple examples of successful projects in the greater metropolitan area recently.
  - These include recent projects in Kársnes in Kópavogur, Lyngás in Garðabær alongside various projects in the new Urriðaholt neighborhood in Garðabær.
- The lowering of interest rates in ISK is injecting fuel into the market.

CPI adjusted price of RRE in the Capital Area



Price (ISK/sq.m.) in the Capital Area

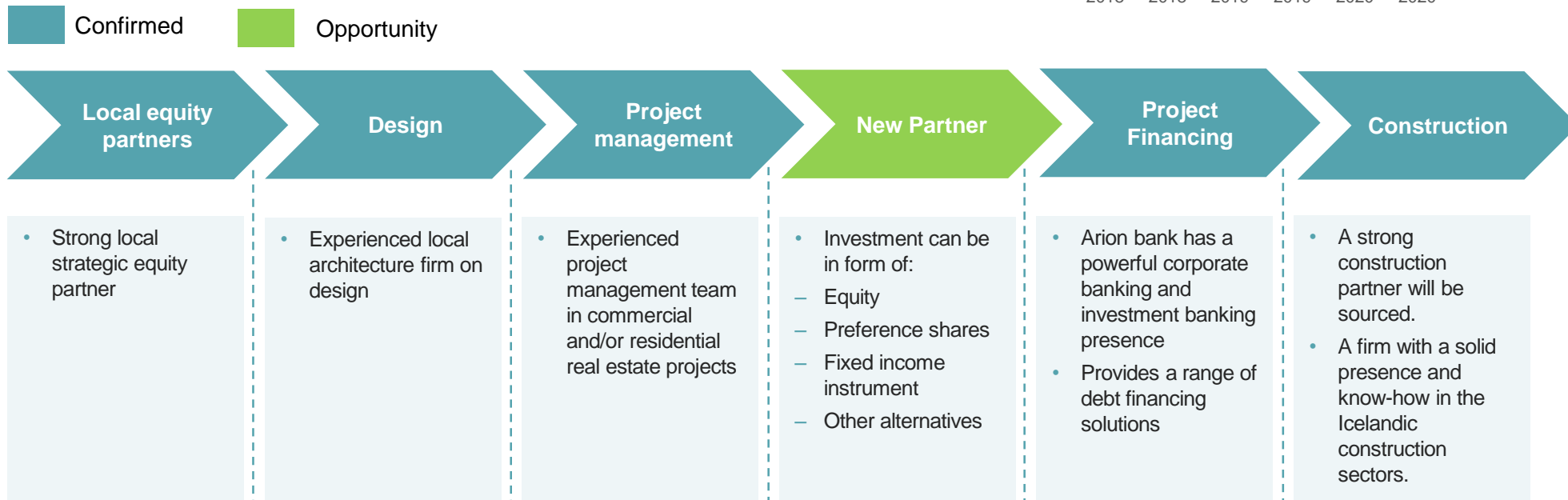
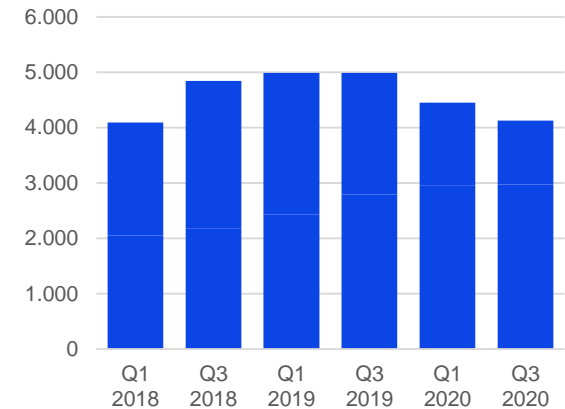


# Other alternatives - Real Estate Development

Opportunity every now and then to invest in development projects

- Given strong residential market, this segment can be an interesting option
- Real Estate in the construction phase, barely keeping up with demand or alleviating housing shortage
- First North listed real estate development company Kaldalón, currently developing approx. ~700 apartments
- Areas under consideration for development in Iceland need to go through a zoning process that consists of two levels, general and detailed zoning
- **Arion bank Corporate Finance could e.g., assist an interested foreign investor with selecting and negotiating partnerships with experienced developers in RRE development projects seeking capital for larger projects.**
- **Theoretical outlines below:**

RRE under construction phase 1 & 2 in the Capital Area<sup>1</sup>

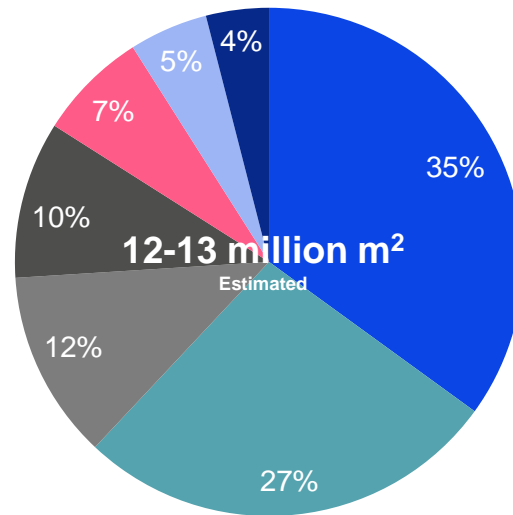


# Other alternatives - Further consolidation of the commercial market

## Commercial market

- The three listed Real Estate companies are accounting for close to 10% of the total estimated market for commercial real estate measured by size
- Room for further consolidation
- Seeking yield through a buy and build strategy
- Buying into an existing private platform for further growth
- Number of larger companies in retail and other industries owning their properties

The commercial real estate market in Iceland



■ Specialized   
 ■ Industry   
 ■ Retail   
 ■ Office  
■ Warehouse   
 ■ Hotel   
 ■ Other

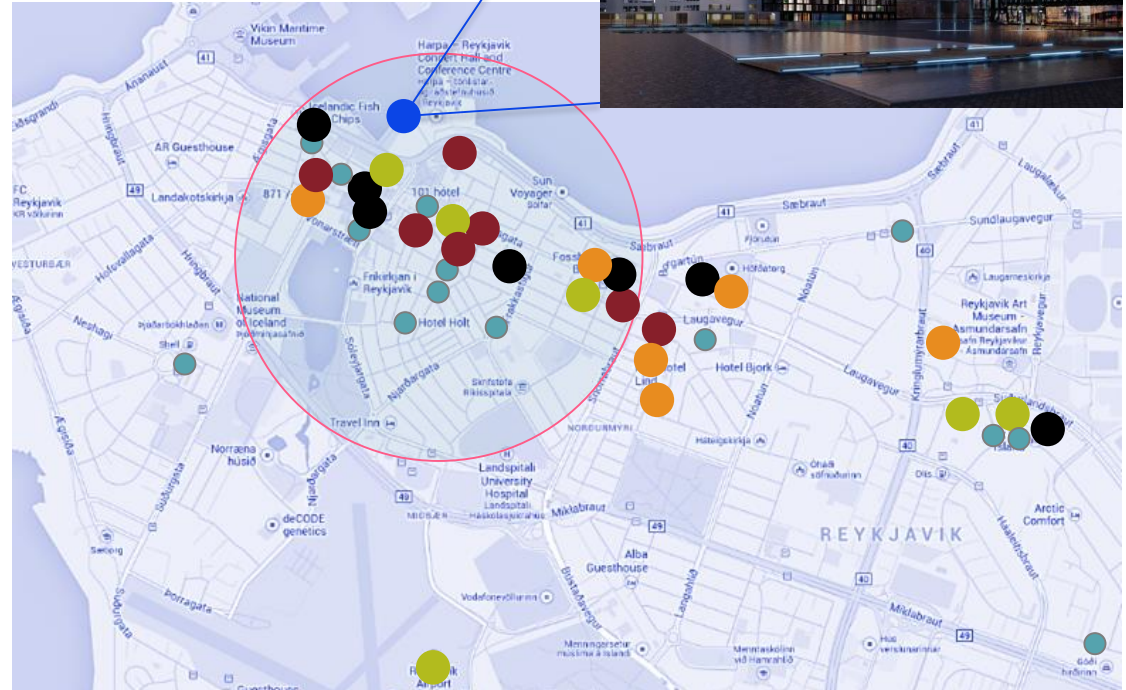


# Reykjavik City hotel market

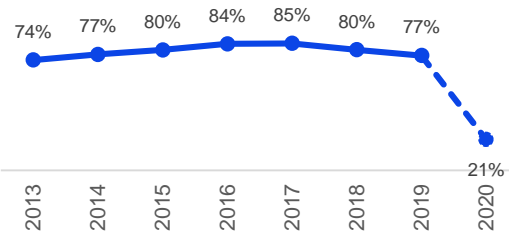
Attractive leisure and future conference destination



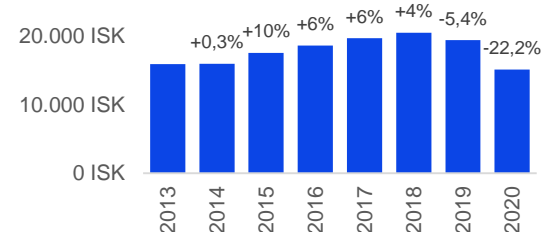
- Most of the largest main hotel brands are strategically located in Reykjavik City Center.
  - CenterHotels (Red circle)
  - KEA Hotels (Black circle)
  - Íslandshótel (Orange circle)
  - Icelandair Hotels (Yellow-green circle)
  - Reykjavik EDITION (Blue circle)
  - Other/Standalone (Teal circle)
- Over the last years there has been a rather steady increase in available hotel rooms in Reykjavik resulting in **nearly 4.900 available rooms in 2020**.
- Reykjavik's first five-star hotel is being built next to Reykjavik's Harpa Concert Hall and Conference Centre.
  - The new luxury boutique hotel will be a Marriott EDITION hotel and offer 253 rooms, event and conference rooms, restaurants and spa facilities.
  - US based investors acquired the development plot and successfully financed the project with local equity investors and project financing from Arion bank in 2016.



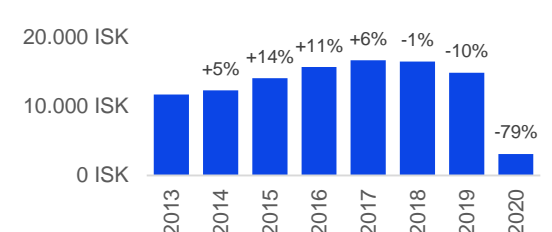
Average occupancy



ADR in Capital Area



RevPAR in Capital Area



# Arion Bank at a Glance

Leading diversified financial institution in Iceland with strong market position

- Team of 700 talented financial service specialists focusing on our clients in our core markets
- Nimble domestic digital leader build on solid foundations of bank's predecessors which trace back to 1930
- Arion Bank is dual listed on the main market in Reykjavik and Stockholm with international and diversified ownership
- Strong emphasis on sustainable and responsible banking

## Retail banking

- Domestic digital leader in retail banking
- Largest private provider of residential mortgages
- One third market share in Iceland
- Wide range of financial services for both individuals and SMEs

## Corporate and Investment banking

- Corporate banking and advisory
- Business relations with large corporates, domestic and foreign
  - Loan syndication
  - Advisory e.g., sale of equity, purchase and financing of firms as well as listing securities on stock exchanges

## Markets

- Largest asset manager in the Icelandic market
- Emphasis on institutional investors and HNW clients
- Leading capital markets house
- Largest custody service provider in Iceland



## Insurance

- Largest life insurance company in Iceland
- 4th largest universal insurance company
- Full range of insurance products and services



## Payments

- Largest card payments company in Iceland (held for sale)

VALITOR



# Arion Bank as a partner with foreign investors

## Sound local presence

**Arion bank is on the forefront of servicing foreign legal entities with business ties to Iceland.**

- We offer customized solutions and meet diverse needs of customers with extensive knowledge, excellent services and a diverse product range.

**We place great emphasis on digital solutions that benefit our customers.**

- Online banking is available for non-Icelandic nationals giving our foreign counterpart option of multiple online users and 24-hour access with a user-friendly platform.
- Online users are authenticated through cell phones to make set up easier and more secure.



## Arion bank can provide all aspects of Corporate and Investment banking services

Financial Advisory, M&A

Debt and Capital Market  
Financing

Current and  
savings accounts

Foreign currency  
accounts<sup>1</sup>

Bank statement reporting  
for foreign clients

Customized debt  
finance solutions

Trading activities

FX advisory  
and services

Hedging, Swaps, etc.

Swift payments

Private banking

Online banking  
in English



# Hedging currency and interest rate risk

Historically low interest rate differential between USD and ISK

## Arion bank can provide various hedging products for investors exposed to currency or interest rate risk

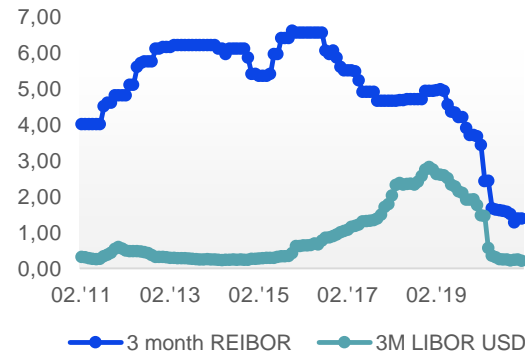
- Strong position on the Icelandic FX market, combining research and sales with strong risk capabilities including **spot, forwards, money market, interest rate products and options**
- An **outright forward**, or currency forward, is a currency contract that locks in the exchange rate and a delivery date beyond the spot value date. It is a simple type of FX forward contract and protects an investor, importer or exporter from exchange rate risk.
- **FX option** is a derivative financial instrument that gives the right but not the obligation to exchange money denominated in one currency into another at a pre-agreed exchange rate on a specified date.
- A **fixed-for-floating swap** is a contractual arrangement between two parties in which one party swaps the interest cash flows of fixed-rate loan(s) with those of floating-rate loan(s) held by another party. The principal of the underlying loans is not exchanged

- There have been large price movements in the USDISK cross over the last 5-years. Over this 5-year period the USDISK cross has fluctuated with an average price of 118,31.
- As a part of risk management, you can lock in the current historically low interest rates and manage your currency risk with hedging products that can be tailored according to investors needs and adjust to the investor's risk appetite

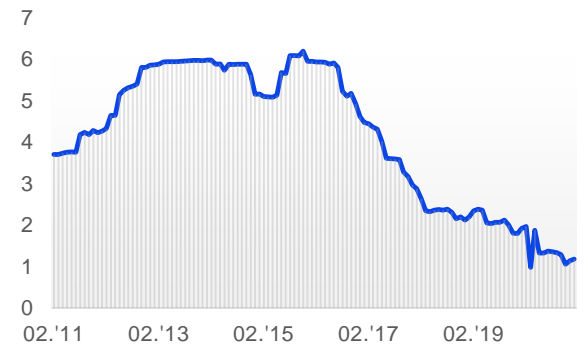
Historical movement of the USDISK cross over



Interest rate differential is historically low



Interest rate differential between USD Libor and Reibor





# Arion Bank Team

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# Macroeconomic environment

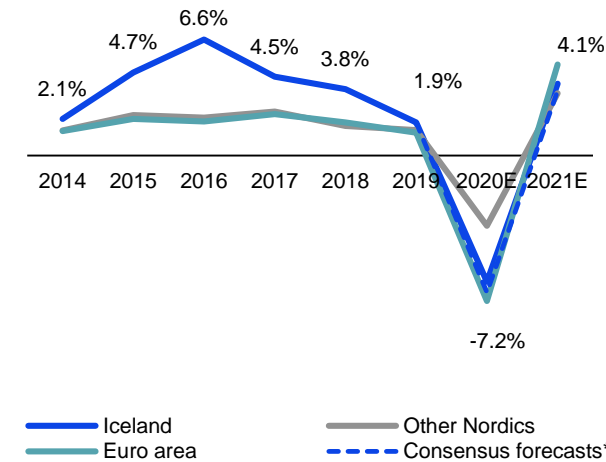


# Macro: Uncertain short-term outlook while the future should be bright

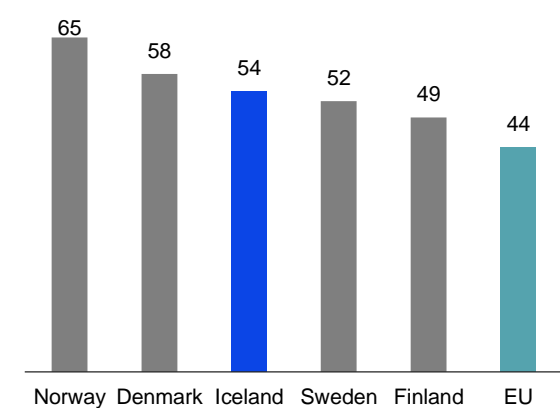
The year is off to a slow start, with the economic contraction set to extend into the year

- The Coronavirus Crisis has heavily impacted the Icelandic economy due to its dependency on foreign trade, especially tourism.
- According to IMF's October forecast Iceland's GDP could shrink by 7.2% in 2020, followed by a rebound in 2021. Domestic analysts are much more pessimistic, with the consensus at 8.2% contraction followed by a softer and more fragile recovery. Despite larger contraction than in other Nordics, GDP per capita will remain high.
- With the resurgence in new Covid-19 cases worldwide and new highly contagious strings of the virus emerging, neighboring countries have responded swiftly, implementing strict measurements and travel restrictions. At the same time Iceland has managed to quell the spread, thus enjoying less restrictions.
- However, strict travel restrictions will be in place until May 1<sup>st</sup>, dampening hopes for a strong high-season in tourism and reflected in unemployment forecasts.
- When borders open a new Iceland should be able to enjoy strong growth in tourism, as the country is sparsely populated, clean, safe and has solid and reliable data in the battle against Covid-19.

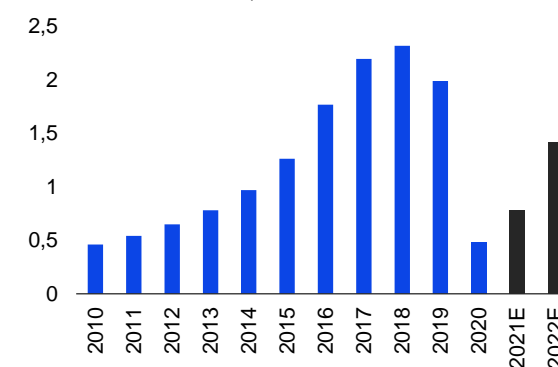
**GDP growth**



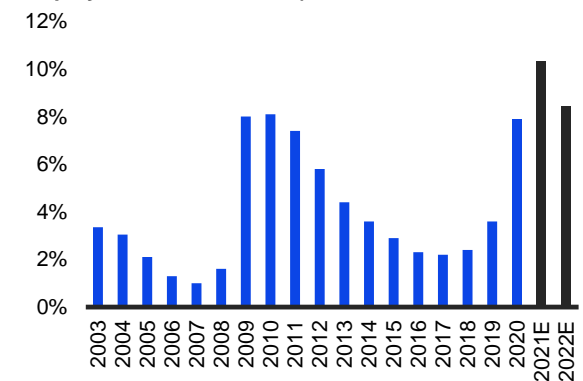
**GDP per capita in 2020 (PPP, International dollars, thous. IMF's estimates)**



**Tourist arrivals via KEF airport (millions, Arion Bank's October 2020 estimates)**



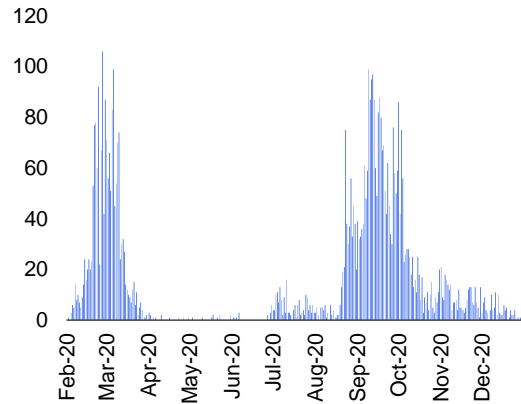
**Registered unemployment, excluding the reduced employment ratio scheme (Arion Bank's estimates)**



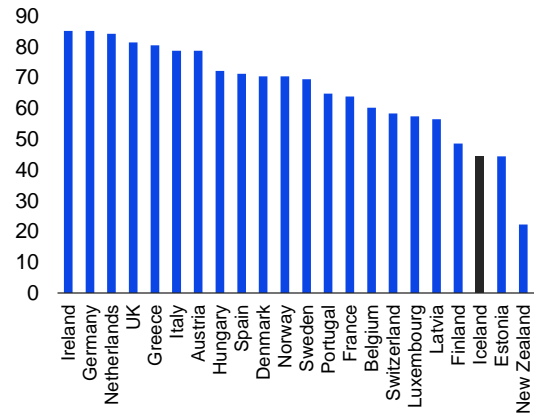
# Macro: Successfully dealing with COVID-19

While neighboring countries have gone into strict lockdown, Icelanders are enjoying relatively soft measures, as reflected by the Government Response Tracker. Vaccination is underway, albeit at a slower pace than many expected. While tourism is still in hibernation mode domestic sectors have witnessed a surge in demand from domestic consumers.

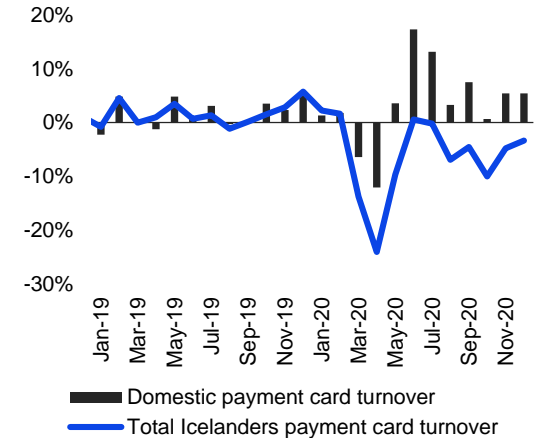
Number of domestic COVID-19 infections



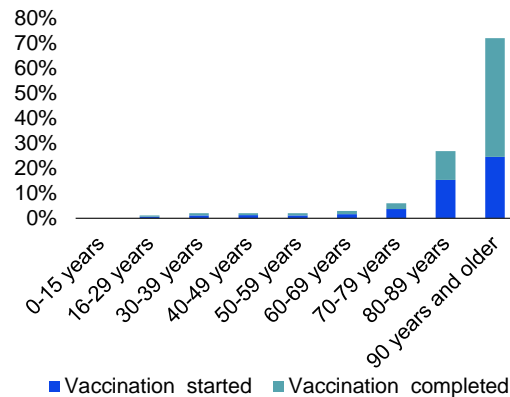
The Oxford COVID-19 Government Response Tracker



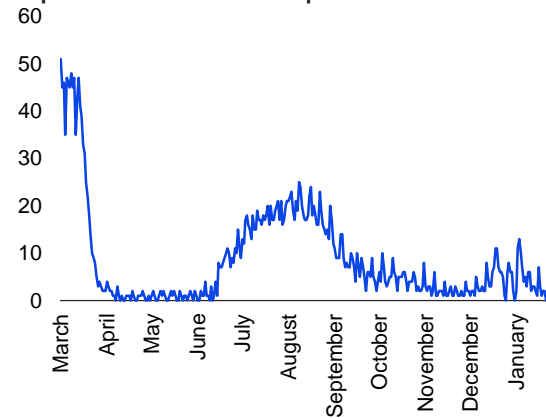
Payment card turnover



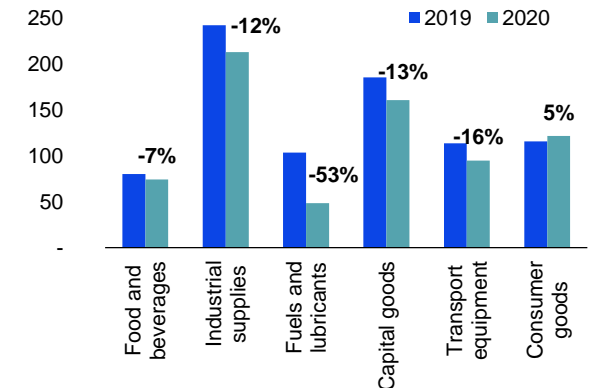
Percentage of vaccinated persons by age



Departures from Keflavik Airport



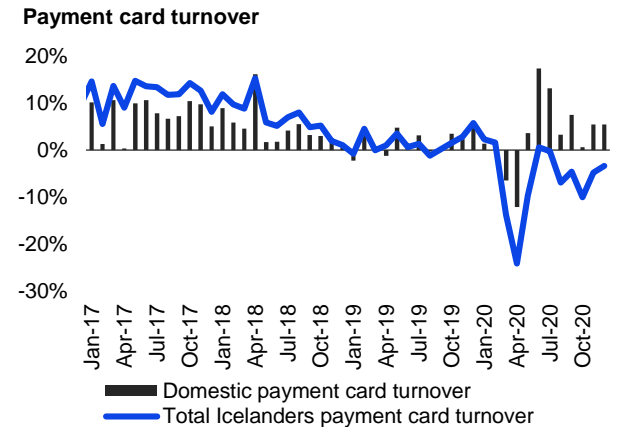
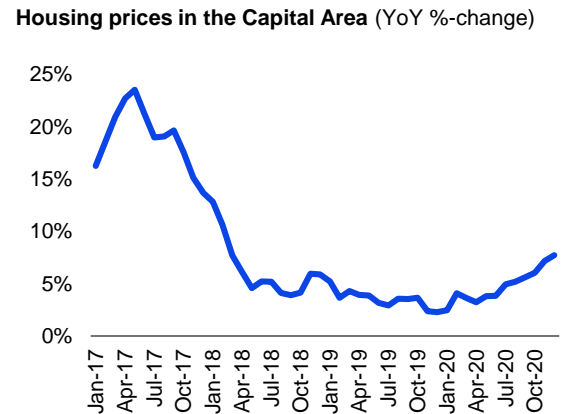
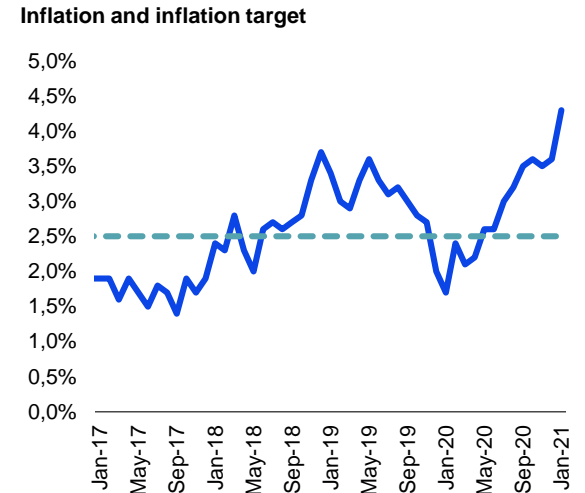
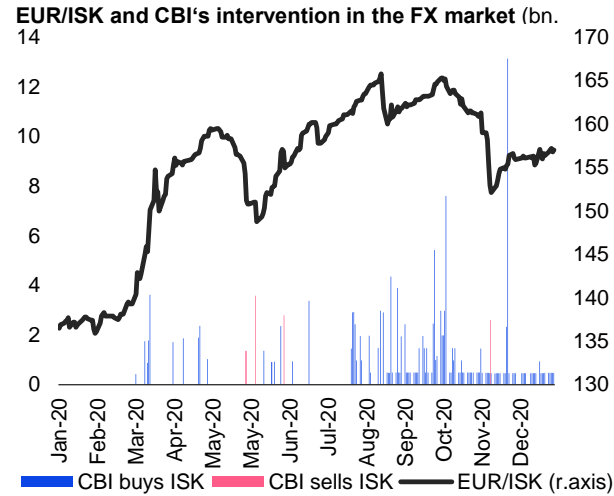
Imported goods – bn. ISK, constant exchange rate, YoY % change



# Macro: Divided domestic market

While unemployment continues to climb wages are on the rise. Despite inflation inching upwards purchasing power has increased, pushing housing prices higher.

- With the largest export sectors struggling, it's no surprise that the ISK has depreciated. The CBI has intervened in the FX market on the most volatile of days, supporting the ISK and keeping the exchange rate relatively stable. In order to deepen the market, the CBI has begun regular program of foreign currency sales.
- Inflation has risen in the past months due to the pass-through from the ISK depreciation and climbing housing prices. Although the rapidness of the rise has come as a surprise, most analysts expect that inflation has peaked, inching below the upper tolerance limit (4%) as the first quarter progresses.
- Rising housing prices have stoked inflationary pressures in the past months following hefty rate cuts. At the same time housing investment is decreasing, causing many to worry that a housing bubble is in the works.
- At the same time as unemployment reaches new heights, real wages are increasing, as reflected in stronger than expected private consumption, and housing prices on the rise, creating a divide in the labor market. This is an uncharted territory in Iceland.

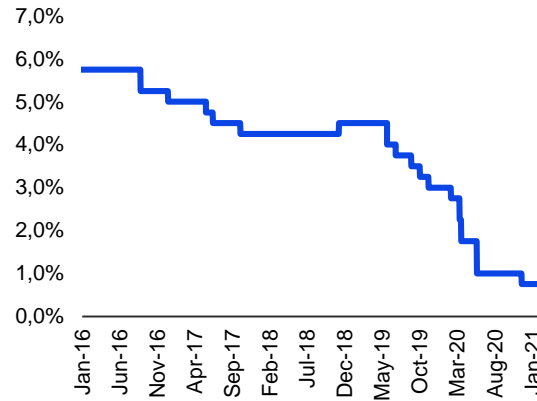


# Macro: Fiscal and monetary responses soften the economic blow

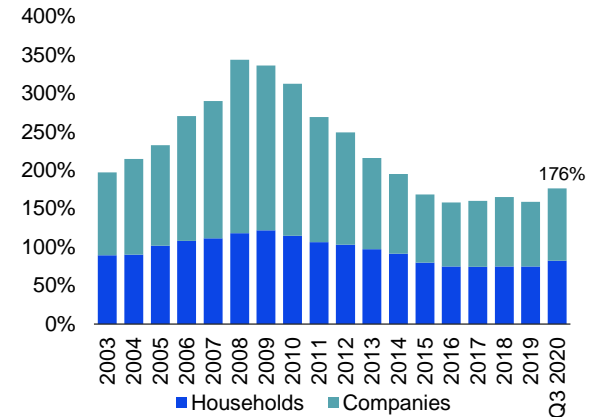
The government and the CBI Governor have underlined that all necessary measures will be taken to support the economy through the crisis.

- Unlike many neighboring countries Icelandic authorities had plenty of firepower at their disposal to support the economy. The CBI has cut interest rates by 2.25 percentage points, eased the countercyclical capital buffer and launched a QE program to name a few. In addition, the CBI has ample FX reserves at its disposal, surely supporting investors confidence.
- The CBI's FX reserves, well balanced external trade, despite everything, and the positive NIIP of the economy mean that balance of payments worries is limited.
- More importantly, both the public and private sectors used the last upswing to deleverage, pushing debt levels to historic lows.
- The Treasury bears the brunt when it comes to protecting the economy. So far numerous fiscal policy measures have been introduced, both aimed at mitigating the revenue shock suffered by households and companies and protecting jobs and companies.
- Direct fiscal measures are similar in scope to those put in place in other Nordic countries, but smaller than on average in advanced economies. However, various other fiscal measures have been implemented, though they do not have the same direct impact on the Treasury outcome.

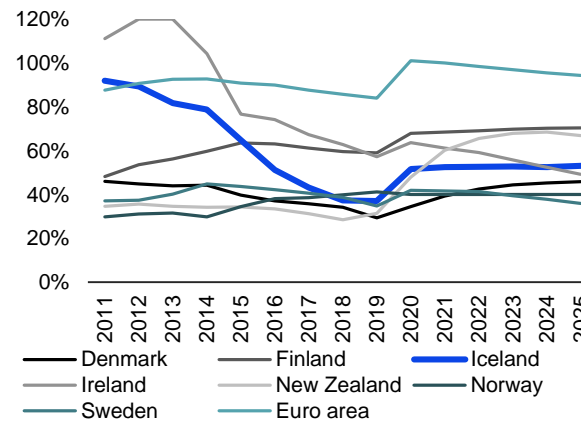
**Key interest rates** (seven-day term deposit rate)



**Household and non-financial corporate debt** (% of GDP)



**General government gross debt** (% of GDP)



**Direct COVID-19 fiscal measures** (% of GDP)

