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Research Update:

Swedish Residential Property Group Willhem Outlook Revised To Negative On Weakening Credit Metrics; Affirmed At 'A-/A-2'

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Rating Action Overview

- Willhem AB (publ)'s credit metrics have weakened, with S&P Global Ratings-adjusted debt-to-debt-plus-equity increasing to 57.6% over the 12 months ended June 30, 2023, from 52.6% a year earlier, and EBITDA interest coverage dropping to 2.5x (for the rolling 12 months) versus 3.7x the previous year.
- We think Willhem's credit metrics may deteriorate even further due to higher-than-expected negative fair value adjustments and greater funding costs, such that the debt-to-debt-plus-equity and EBITDA coverage ratios weaken beyond our thresholds of 60% and 1.8x, respectively, for the 'A-' rating.
- We therefore revised to negative from stable our outlook on the long-term rating on Willhem and affirmed the ratings at 'A-/A-2'. We also affirmed the 'K-1' Nordic regional scale rating on Willhem.
- The negative outlook reflects a one-in-three likelihood of a downgrade in the next 12-24 months if Willhem's credit metrics weaken beyond our current forecasts.

Rating Action Rationale

Willhem's debt-to-debt-plus-equity ratio will likely increase in 2023-2024 amid continued negative fair value adjustments. At June 30, 2023, S&P Global Ratings-adjusted debt to debt plus equity stood at 57.6% versus 52.6% at mid-2022 and 54.1% at end-2022, and the current level corresponds to reported loan to value (LTV) of 53.4 %. The deterioration stems mainly from a 6.3% portfolio devaluation in the first half of 2023 following a 3.1% decline in fourth-quarter 2022. In our view, Willhem approached the fair value adjustment conservatively, evident in a 50 basis points yield expansion since the trough of 3.1% at June 30, 2022. Yet, the current valuation yield remains relatively low at 3.6%. Considering the current market uncertainties, with rising interest rates and limited transaction volumes (reflecting discrepancies of buyers and seller price expectation), we anticipate some further negative fair value adjustment for the second half of 2023 of 3%-4% and another 3%-5% downward adjustment in 2024. This would increase S&P Global Ratings-adjusted debt to debt plus equity to 59%-61% over the next 12-24 months. We understand that Willhem is committed to its current financial policy, targeting a reported LTV below 60% (translating into a debt-to-debt-plus-equity of up to 65%). Also, we consider the company's efforts to preserve capital and strengthen the balance sheet by cutting dividend to zero in 2023 from Swedish krona (SEK) 501 million in 2022. However, adjusted leverage ratios could be highly sensitive if valuations are weaker than our current forecast or the company fails to maintain sufficient headroom under the ratings thresholds of a debt to debt plus equity below 60%.

Rating pressure could also intensify if higher refinancing costs cause Willhem's EBITDA interest coverage, as adjusted by S&P Global Ratings, to weaken more than anticipated in 2023-2024. In our view, Willhem has significant exposure to increasing interest rates, which could materially affect the company's funding costs over the next 12-24 months. Willhem's loan portfolio includes an average fixed-interest rate term of 3.3 years but about 34% of these mature in the next 12 months. In addition, the company's exposure to pure floating-rated debt is about 25%, which immediately affects funding costs. We anticipate that company's average cost of debt to rise to at least 3.0% in 2023 and 2024 from 2.5% at mid-2023 and 1.5% at mid-2022. We assume this will likely result in an overall weaker debt-service capacity, leading us to anticipate that S&P Global Ratings-adjusted EBITDA interest coverage will fall to 1.8x-2.0x in 2023-2024 from 2.5x at mid-2023 and 3.7x at mid-2022. This tightens the headroom at the current rating level. Also, we see a risk that the company's new funding costs surpass our current projections or that margins contract. These developments might cause EBITDA interest cover to fall below, or hover near, our downside threshold of 1.8x over a prolonged period.

We expect the operating fundamentals for Willhem's properties to remain stable, thanks to good demand for residential assets in its markets, where new supply continues to be limited. For the first six months of 2023, the company reported positive like-for-like rental income growth of 3.9% as well as a high and stable real occupancy rates of 98.2% (excluding vacancies due to refurbishments) for its overall portfolio. Overall, Willhem's portfolio spans 13 Swedish cities with healthy population growth, solid demand, and limited housing. We therefore expect continued positive like-for-like rental growth in the range of 2%-4% over the next 12-24 months and occupancy sustained at 98%-99%. Over the next 12 months, we anticipate that Willhem's operating performance should be broadly unchanged, with the gross EBITDA margin remaining at 58%-60%, where rent indexation and completed projects may be offset by increased utility costs that cannot easily be passed over on the Nordic market since tenants pays a fixed rent (including energy and heating costs).

Our rating on Willhem incorporates a one-notch downward adjustment for our comparable rating analysis. Willhem's leverage metrics are in the lower end of our significant financial risk category. In addition to the aforementioned weakened debt to debt plus equity, the company's debt to EBITDA stands above 15x because of the low yield asset portfolio, and we anticipate further deterioration of the EBITDA interest coverage to close to 1.8x. We also take into account that the possibility of S&P Global Ratings-adjusted debt to debt plus equity moving to 60%-65% since the company's financial policy allows for a reported LTV ratio of 55%-60%. Furthermore, Willhem is much smaller in scale and geographically less diversified than other rated residential real estate peers with the same business risk assessment, such as Dutch residential real estate landlord Vesteda (€8.99 billion in assets as of June 30, 2023) or Germany-based Grand City Properties (€8.99 billion). Our one-notch downward adjustment also reflects the short debt maturity length relative to higher-rated residential peers'. Willhem's debt maturity profile of 2.3 years (3.1 years including the undrawn committed revolving credit facility [RCF]) implies high refinancing needs over the short to medium term. This is due to high usage of commercial paper, representing about 14% of interest-bearing debt and currently about 34% of the debt will mature within the next 12 months. We expect Willhem to extend its current debt maturities to be more in line with other Nordic rated peers.

Willhem's cash on the balance sheet and committed credit facilities, including from its owner state owned pension fund AP1, ensure it retains adequate liquidity, despite the high amount of short-term debt maturities of commercial papers. Willhem has a relatively large debt maturity of SEK12.2 billion coming due in the next 12 months. We understand that Willhem is targeting to roll over maturing debt in a timely manner, and we notice that, over the past year, the company has had no issue accessing the debt capital market to roll over short-term debt. We also notice that liquidity uses are fully covered by its SEK3.6 billion of available cash and cash equivalents and about SEK17.4 billion under its committed undrawn back-up facility, which matures beyond June 2024. This includes a long-term committed agreement by AP1 to subscribe to commercial paper up to SEK8 billion, fully covering its commercial paper program. In our view, this supports Willhem's liquidity and limits the refinancing risk associated with short-term debt maturities. We understand that the proceeds from the agreement with AP1 could be used to repay all types of interest-bearing debt.

We continue to view Willhem as a strategically important subsidiary of AP1. Willhem is 100% owned by Swedish sovereign wealth fund AP1, which acts as a buffer fund for the Swedish National Public Pension system. We understand AP1 is involved in defining Willhem's strategies and it considers Willhem a long-term core investment. Moreover, we anticipate AP1 will maintain its current shareholding. In addition to the support available via the commercial paper agreement with AP1, we expect AP1 would help Willhem, if needed, with a capital injection. We therefore continue to incorporate a three-notch uplift for group support in our rating on Willhem, as per our methodology.

Outlook

The negative outlook captures the possibility of a downgrade in the next few quarters if Willhem's credit metrics weaken beyond our current base-case projections. At this time, we anticipate tight ratings headroom, with EBITDA interest coverage declining toward 1.8x-2.0x and debt to debt plus equity at, or just below, 60% over the next 24 months.

Downside scenario

We could consider a negative rating action if:

- Debt to debt plus equity increases to 60% or above for a prolonged period because of higher negative asset revaluation or a larger-than-expected debt-financed investment.
- EBITDA to interest nears 1.8x, or below, for a sustained period, for instance due to higher funding costs or materially weaker-than-expected operating performance.
- Willhem's standing in the debt capital markets deteriorates, creating refinancing risks, notably with respect to its commercial paper and bonds.
- A change in AP1's approach and commitment to its investment in Willhem prompts us to see a

reduced likelihood of extraordinary support.

Upside scenario

We could revise our outlook to stable if Willhem:

- Sustains an EBITDA interest coverage sufficiently above 1.8x;
- Debt to debt plus equity is well below 60%;
- Retains a good access to capital markets for refinancing needs; and
- Does not experience a change in the shareholder's strategy or commitment toward the company.

Company Description

Willhem is a Swedish private property company with a portfolio value of SEK56.8 billion (about €5.7 billion) at June 30, 2023. Willhem operates primarily in the residential sector (93% of property value), owning about 28,600 residential units. The company is active in 13 cities in Sweden with main operations in Stockholm (15% of total portfolio value as of June 30, 2023), Gothenburg (12%), Borås (12%), and Helsingborg (11%).

The company was founded in December 2010 and is 100% owned by Swedish pension fund AP1.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Sweden of negative 0.5% in 2023, then improving to 1.0% in 2024. We project consumer price index growth of 7.6% in 2023 and 3.2% in 2024.
- Annual like-for-like rental growth of 2%-4% in the next two years, based on yearly negotiations and stemming from some rent uplift by refurbishment
- A sustained high occupancy rate of 98%-99% in the next 12-24 months, reflecting strong demand for regulated residential assets.
- Total capital expenditure (capex) of SEK1.1 billion-SEK1.3 billion annually over the coming two years. We also forecast some smaller portfolio acquisitions of about SEK400 million in 2023 and SEK200 million in 2024.
- Steady gross EBITDA margins of 58%-60% over the next few years, as increased costs are offset by higher rents and efficiency enhancement.
- Between 8% and 10% negative annual portfolio devaluation in 2023, driven by a slight yield expansion for residential assets and another 3%-5% in 2024.
- No dividends in 2023-2024.
- Average cost of debt to increase to at least 3% in the next 12-24 months.

Key metrics

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures over the next 12-24 months:

- Adjusted EBITDA to interest coverage of 1.8x-2.0x;
- Adjusted debt to debt plus equity of 58%-60%; and
- Adjusted debt to EBITDA of 16x-18x.

Liquidity

Our assessment of Willhem's liquidity profile as adequate is supported by its access to committed bank lines and the long-term commitment from its owner for subscription of commercial papers. We forecast that the company's liquidity sources will exceed its funding needs by 1.2x over the next 12 months. We view positively that Willhem covers its full commercial paper program of SEK8 billion with long-dated committed bank lines, maturing beyond the next 12 months.

Our estimate of Willhem's principal liquidity sources at June 30, 2023, include:

- Unrestricted cash balance of SEK 3.6 billion;
- The undrawn committed RCF of SEK17.4 billion (maturing beyond the coming 12 months), including SEK8 billion in committed contractual agreement from its owner to subscribe commercial paper; and
- Our expected cash funds from operations (FFO) of SEK1.1 billion-SEK 1.3 billion.

According to our estimates, this corresponds to the following principal liquidity uses:

- Short-term debt maturities, including commercial paper, of SEK12.2 billion;
- Committed capex of about SEK330 million; and
- No dividends in 2023.

Covenants

Willhem has covenants under its outstanding bank debt and credit lines. We understand that headroom under these covenants is adequate, at more than 10%. We expect Willhem to maintain sufficient headroom under all outstanding and future financial covenants.

Willhem's main financial bank covenants are:

- An LTV ratio of no more than 70% (53.4% as of June 30, 2023).
- An interest coverage ratio above 1.7x (2.5x as of June 30, 2023).

Environmental, Social, And Governance

Environmental, social, and governance factors are an overall neutral consideration in our credit rating analysis of Willhem. The company targets a 50% reduction of its energy consumption by

2030 (from the 2013 base level) and achieving net-zero emissions by the same year. The company had secured green financing of about 24% of its total interest-bearing debt at June 30, 2023. Willhem is 100% owned by Swedish sovereign wealth fund AP1, which acts as a buffer fund for the Swedish National Public Pension system. We understand that AP1 considers Willhem a core, long-term investment.

Ratings Score Snapshot

Issuer Credit Rating	A-/Negative/A-2
Business risk:	Strong
Country risk	Very low
Industry risk	Low
Competitive position	Strong
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bbb-
Entity status within group	Strategically important (+3 notches from SACP)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Willhem AB (publ)		
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2
Nordic Regional Scale	--/--/K-1	--/--/K-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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