

Research Update:

Willhem AB (publ) 'A-' Ratings Affirmed Following Transition To Corporate Rating Methodology; Outlook Stable.

September 2, 2021

Rating Action Overview

- On June 3, 2021, Willhem was placed on CreditWatch with negative implications following our consideration that its mission is to maximize profits rather than provide a public service, therefore falling out of scope of our updated "Methodology For Rating Public And Nonprofit Social Housing Providers," published June 1, 2021, on RatingsDirect.
- However, we continue to recognize the company's very high cash flow stability and solid EBITDA interest coverage derived from its assets, despite its elevated debt leverage under our criteria for corporates. We also think the company would likely benefit from extraordinary support from its 100% shareholder The First National Pension Fund (AP1) in case of financial distress.
- We therefore affirmed our 'A-/A-2' long- and short-term issuer credit ratings, three notches above the 'bbb-' standalone credit profile (SACP), and 'K-1' Nordic regional scale rating on Willhem--applying our "Key Credit Factors For The Real Estate Industry" criteria published Feb. 26, 2018.
- The stable outlook reflects our anticipation that Willhem's portfolio should continue to generate solid and predictable cash flows over the next 12-24 months, with an S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio of about 55%, and an adjusted EBITDA interest coverage ratio of about 3.5x.

PRIMARY CREDIT ANALYST

Teresa Stromberg
Stockholm
(46) 8-440-5922
teresa.stromberg
@spglobal.com

SECONDARY CONTACT

Nicole Reinhardt
Frankfurt
+ 49 693 399 9303
nicole.reinhardt
@spglobal.com

Rating Action Rationale

The affirmation reflects our application of the "Key Credit Factors For The Real Estate Industry" in our credit assessment for Willhem and the potential likelihood of extraordinary support that Willhem would receive from its owner AP1. On June 3, 2021, Willhem was placed on CreditWatch with negative implications following our consideration that its mission is to maximize profits for its shareholders rather than provide a public service. This meant it fell out of scope for our updated "Methodology For Rating Public And Nonprofit Social Housing Providers," published

June 1, 2021, which particularly excludes entities that are commercially motivated. We now assess Willhem under our corporate rating methodology for real estate holding companies. Our rating assessment also incorporates the potential likelihood of extraordinary support that Willhem could receive from its shareholder AP1, under our "Group Rating Methodology" criteria, published July 1, 2019,

We expect Willhem's residential property portfolio will generate stable and predictable cash flows over the business cycle, supported by the Swedish regulated residential property market's favorable fundamentals. The rating affirmation reflects our view of the company's resilient property portfolio, with Swedish krona (SEK) 50.3 billion (as of June 30, 2021) of regulated residential assets (91% of portfolio value) comprising close to 27,000 apartments. Willhem is one of the largest residential landlords in Sweden and we believe its assets are well spread among regions where fundamentals should be supported by solid demand, and limited new supply. The portfolio is mainly exposed to Greater Stockholm (15% of the total property portfolio), Gothenburg (12%), Borås (12%) and Helsingborg (11%) as of June 30, 2021, all of which benefit from solid population growth and have housing shortages. Overall, Willhem's portfolio has benefited from a sustained high occupancy rate of 98%-99% (99.7% as of June.30, 2021, excluding apartments under refurbishment) on average over the past decade, which supports stable and predictable cash flows. That said, we estimate that about 15%-20% of the company's portfolio is based in smaller secondary locations in Sweden, where macroeconomic fundamentals, such as population and wage growth, are less favorable than in metropolitan areas such as Stockholm or Malmö.

We believe Willhem will continue to expand its residential portfolio within existing areas of operation although at a slower pace than over the past few years. Having previously focused on rapid expansion through extensive acquisitions and investments, we now anticipate Willhem will enter a slower pace of growth for its property portfolio. On the back of yield compression for residential assets over the past 12-18 months in the Swedish real estate market, the company has been more selective in terms of acquisitions and investments, demonstrated by the slight slowdown in capital expenditure (capex) over the past two years. We expect fewer acquisitions over the next 12-24 months than previously. Nevertheless, we assume that the company will continue to expand the business, primarily organically, and we expect capex of SEK1.3 billion–SEK1.5 billion per year over 2022-2023.

We expect Willhem's leverage ratios to remain at current levels, with comfortable headroom under its financial policy. Our assessment of Willhem's financial risk profile is based on the company's solid EBITDA interest coverage ratio of about 3.5x, supported by its low cost of debt of about 1.3%, as well as our expectations of an adjusted debt to debt plus equity of about 55% in the next 12-24 months (55.8% as of June 30, 2021). We forecast the latter will remain at similar levels over the next 12-24 months, which would imply leverage metrics stay comfortably within its financial policy of a maximum 60% loan to value (LTV). This translates into our adjusted ratio of debt to debt plus equity of about 65%. That said, we anticipate that the company's debt to EBITDA will likely remain high at about 17x-18x, underpinned by the low yielding environment for residential assets.

Willhem's average debt maturity length is a relative weakness compared to that of other rated residential players. Our assessment also considers the company's capital structure, which is largely unsecured but with high usage of low yielding commercial paper, representing about 19% of interest-bearing debt. The company's average debt maturity profile of only 2.3 years means high refinancing needs over the short-to-medium term. This is also significantly lower than other

rated residential real estate companies, which mostly have well above a five-year weighted average debt maturity. We believe further shortening of the debt maturity profile could pressure the company's liquidity and the overall rating assessment.

Our rating on Willhem incorporates a one-notch downward adjustment for our comparable rating analysis, reflecting its higher leverage and relatively small asset base compared to those of peers with a higher rating assessment.

Compared to other rated residential peers, Willhem's leverage metrics appear relatively high with debt to debt plus equity of above 55% and a debt to EBITDA of 17x-18x. We also note that the financial policy allows for an LTV ratio of 55%-60%, translating into S&P Global Ratings-adjusted debt to debt plus equity of 60%-65%. However, we understand that Willhem will likely keep sufficient headroom under its financial policy. 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 Swedish residential real estate landlord Heimstaden (SEK186.1 billion in assets as of June 30, 2021) or Akelius (€12.9 billion),

We apply three notches of uplift to our bbb-' SACP because we consider AP1's holding in Willhem strategically important with a high likelihood of group support, under our methodology.

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 long-term core investment and has no intention to divest the holding, justified by its stable, predictable cash flows and limited correlation to other holdings in the portfolio, and we expect AP1 would support Willhem in the case of financial difficulties. More specifically, based on publicly stated capitalization targets for Willhem, AP1 is committed to injecting capital if Willhem's capitalization falls below a minimum equal to an LTV of 60%. In addition, Willhem holds a contractual agreement whereby AP1 commits to subscribe to commercial paper of up to SEK6 billion. We further understand that financial covenants in Willhem's loan agreements indicate that AP1 is committed to remaining Willhem's majority shareholder.

Outlook

The stable outlook on Willhem reflects our expectation of continued favorable demand for midsize residential apartments in major Swedish cities, where new supply remains limited. We expect like-for-like rental income will increase 1.5%-2.0% in the next 12-24 months. We also anticipate that the company's S&P Global Ratings-adjusted EBITDA interest coverage will remain at above 3.5x and debt to debt plus equity at about 55% over the next 12-24 months.

In addition, the stable outlook incorporates no change to our view of the company's shareholder structure and the strategy of AP1 toward Willhem.

Downside scenario

We could lower the rating if Willhem's debt to debt plus equity increases above 60% or its EBITDA interest coverage declines toward 1.8x or below on a sustainable basis. This could occur following higher-than-expected debt-financed investments or acquisitions or materially weaker than anticipated operating performance.

A negative rating action could also occur if the company's capital structure or liquidity deteriorates, for example, due to its average remaining debt maturity falling below two years or significant short-term refinancing needs, including commercial paper.

We could also lower the rating if there is a change in the owner's approach and commitment to its investment in Willhem, which could lead us to revise our view of support from AP1.

Upside scenario

We could raise the rating if Willhem's credit metrics strengthen beyond our base case, driving improvements in its overall financial risk profile. This could occur if debt to debt plus equity declines sustainably well below 55%, as part of a more conservative financial policy, with EBITDA interest coverage maintained at least at 3x and debt to EBITDA toward 13.0x on a sustainable basis.

That would also assume no change in the shareholder's strategy or commitment toward Willhem.

Company Description

Willhem is a Swedish private property company with a portfolio value of SEK50.3 billion as of June 30, 2021 (about €5.3 billion). Willhem operates primarily in the residential sector (91% of property value), owning about 27,000 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, 2021), 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

- Like-for-like rental growth of 1%-2%, in line with inflation in Sweden (estimated at about 1.6%-1.9%) in addition to some minor rent increases for refurbishment and new development.
- A sustained high occupancy rate of about 98%-99% in the next 24 months, reflecting strong demand for regulated residential assets.
- Capex of approximately SEK1.1 billion-SEK1.3 billion per year in 2021 and 2022. In addition, we forecast portfolio acquisitions of about SEK1.5 billion and SEK2.3 billion in 2021 and 2022, respectively.
- About 3% positive annual portfolio revaluation in 2021-2022, supported by indexation and a slight yield compression for residential assets.
- Dividend payments of about SEK500 million annually, in line with the company's policy.
- Average cost of debt to remain stable at about 1.4%-1.5%.

Key metrics

Based on these assumptions, we arrive at the following credit measures over the next 12-24 months:

- EBITDA to interest coverage of about 3.5x;
- Adjusted debt to debt plus equity of about 55%; and

- Debt to EBITDA of 17x-18x.

Liquidity

Our assessment of Willhem's liquidity profile as adequate is supported by its access to committed bank lines. 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 SEK6.0 billion with long-dated committed bank lines, maturing in more than 12 months.

Principal liquidity sources as of June 30, 2021, include:

- Unrestricted cash balance of SEK1.7 billion;
- The undrawn committed revolving credit facility (RCF) of SEK11.6 billion maturing beyond 12 months;
- Our expected cash funds from operations (FFO) of SEK1.1 billion-SEK 1.3 billion; and
- Committed asset sales of SEK 82 million.

Principal liquidity uses over the same period include:

- Short-term debt maturities, including commercial paper, of SEK9.6 billion;
- Committed capex of about SEK100 million;
- Committed acquisitions of about SEK806 million; and
- Dividend payments of SEK500 million.

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.

The main financial bank covenants for Willhem are:

- An LTV ratio of no more than 70% (50.4% as of June 30, 2021).
- An interest coverage ratio above 1.7x (3.2x as of June 30, 2021).

Ratings Score Snapshot

Issuer Credit Rating: A-/Stable/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: 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Related Research

- Willhem AB Put On CreditWatch Negative On Considered Commercially Motivated Under Updated Social Housing Methodology, June 3, 2021

Ratings List

Ratings Affirmed; Outlook Action

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

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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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