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Research Update:

Swedish Housing Company Willhem Affirmed At 'A-/A-2'; Outlook Stable

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Overview

- Willhem has decided to expand its operations into community service properties, and we think these assets will become an increasingly important part of its total portfolio. Although we view these assets as slightly riskier than Willhem's rental housing properties, we regard the company's focus on public sector tenants as a mitigating factor.
- Willhem's aggressive expansion in recent years has led to rapid growth in its nominal debt stock, which burdens our assessment of the financial profile. This is to some extent offset by solid financial performance, strong economic fundamentals, and a commitment from the owners to limit leverage within specified ratio ranges.
- We are affirming our 'A-/A-2' ratings on Willhem.
- The stable outlook reflects our expectation that, over the next two years, Willhem's risks will remain stable, supported by strong enterprise and financial profiles.

Rating Action

On Dec. 5, 2017, S&P Global Ratings affirmed its 'A-' long-term and 'A-2' short-term issuer credit ratings on Swedish public housing company Willhem AB (publ). The outlook is stable.

At the same time, we affirmed our 'K-1' Nordic regional scale rating on the company.

Rationale

The ratings reflect our assessment of Willhem's strong enterprise and financial profiles, based on low industry risk, very strong asset quality, strong economic fundamentals, and strong financial performance. These strengths are partly offset by Willhem's high leverage and a somewhat higher exposure to properties in less attractive locations, especially compared with municipal-owned peers.

We consider Willhem's enterprise profile to be strong, supported by low industry risk and strong economic fundamentals. As of October 2017, Willhem owned 26,000 apartments, up 14% from 2016. We expect the company's growth in the rental housing segment will decrease somewhat, owing to its decision to switch its focus to expansion in community service properties. Still, we view Willhem as open to acquiring housing properties as well, if an opportunity arises.

Willhem benefits from robust demand for most of its rental properties, which means it has low vacancies. Where the company is present, we calculate the average price for private houses at 120% of the national average. Combined with average population growth of 1.27% annually in these cities over the past three years, this suggests

robust local economic fundamentals. Willhem operates in 13 selected cities, within Sweden's three main metropolitan areas or regional centers, with good demand for rental apartments. We do not foresee any imminent demand risk in Willhem's main markets, although we still consider Willhem's higher-than-peers exposure to less attractive locations within cities to be negative for the ratings because it could lead to increased risk of higher vacancies, reduced prospects for property sales, lower potential to finance refurbishments by increasing rents, and potential reputational risk if Willhem were not to act as a socially responsible landlord.

Willhem has taken the formal decision to expand operations into community service properties. We believe that these assets will become an increasingly important part of Willhem's total portfolio within a few years, which, depending on its relative size of operations, may affect our view of Willhem's future enterprise risk negatively. Although we consider community service properties as somewhat riskier than housing, we view Willhem's focus on public sector tenants with long lease contracts as a mitigating factor.

We continue to view Willhem's financial profile as strong, supported by its solid financial performance, with five-year average EBITDA to revenues at a healthy 44.5%. We now treat capitalized maintenance as an operating expense, which burdens our EBITDA calculation. Nevertheless, the company's earnings are robust. Under our base case, we expect margins will gradually improve on the back of steady acquisitions and investments in existing properties, which enable rent increases. Willhem intends to invest approximately Swedish krona (SEK) 4.3 billion (€432 million) annually in 2017-2019. We estimate these planned investments will add about SEK2.6 billion in net new loans per year. We forecast the company's ratio of debt to EBITDA at 22.4x and EBITDA interest coverage at 2.9x in 2019, up from 2.7x in 2016. As regards the remaining investments, we understand Willhem will finance them with operating cash flows.

We continue to assess Willhem's debt position as vulnerable, primarily because of its high leverage and short-dated debt maturity profile. Taking capitalized maintenance into account, we calculate five-year average debt to EBITDA at 22x. In our base-case scenario, we expect debt metrics will remain stable. We have not factored asset sales into our forecast, but we think potential asset sales could decrease borrowing needs. Moreover, Willhem has a target range of 60%-65% for loan to value, with which we expect it will comply. In October 2017, its adjusted loan-to-value ratio was 60.4%. We view positively Willhem's decision to lengthen its interest-rate fixing, to an average of six years, from four, since it reduces the company's exposure to interest-rate risks and could diminish refinancing risk in the portfolio. Bonds will be refinanced with a longer tenor as they mature. In the short run, we understand Willhem will lengthen interest-rate fixing using interest derivatives. By the end of October, interest maturing within 12 months amounted to 32%, compared with 46% in 2016.

The Swedish sovereign wealth fund Första AP-fonden owns Willhem. The owner is actively involved in defining the company's strategy and has indicated its intentions to maintain full ownership of Willhem. We understand that Första AP-fonden considers Willhem to be a long-term core investment. The owner provides

ongoing support through an agreement to subscribe to commercial paper if Willhem encounters difficulties issuing in the market, an openly communicated target for capitalization (implying that the owner would inject capital if capitalization fell below the minimum target), and financial covenants in loans agreements indicating that Första AP-fonden will remain as majority owner.

Liquidity

Willhem's liquidity position is adequate, based on liquidity sources covering 1.17x of liquidity uses and our view of Willhem's satisfactory market access. Debt maturing within 12 months totals SEK6.7 billion, together with SEK4.1 billion in capital expenditures and interest, add to the company's short-term liquidity needs.

Willhem has SEK10.4 billion in credit facilities, including the agreement with the owner to guarantee the refinancing of the commercial paper program. Adding cash, liquid assets, and inflows of an additional SEK2.1 billion, we calculate the liquidity sources at 1.17x liquidity uses over the next 12 months, up from 1.05x in 2016.

Willhem has a range of funding options. Most of its funding is through an SEK6 billion commercial paper program, an SEK14 billion medium-term note program, and bank loans. We continue to assess Willhem's market access as satisfactory, which is in line with other non-municipal-owned peers.

Outlook

The stable outlook reflects our expectation that Willhem will maintain its strong enterprise profile over the next two years, supported by low vacancies and sound economic fundamentals. Despite its relatively high leverage and debt accumulation, the company's financial profile will likely remain strong and stable at current levels, supported primarily by a very strong financial performance and the owner's commitment to limit leverage. Furthermore, we expect Willhem will start its expansion into community service properties. Although we believe it will become an increasingly important part of the portfolio, the company's activity in this segment will remain fairly limited, in our view, compared with its rental housing operations.

We could raise our ratings if Willhem's financial profile strengthened. This could happen if Willhem's liquidity position strengthened more than we expect, with liquidity sources sustainably exceeding uses by more than 125%; the ratio of debt to EBITDA improved significantly from slower debt accumulation; and EBITDA to revenue stayed persistently above 50%. In addition, we could consider a positive rating action if Willhem adjusted the composition of its property portfolio so that the distribution of properties was closer to that of rated municipal-owned Swedish public housing peers.

The ratings could come under pressure if Willhem's financial profile deteriorated. This could occur if the debt profile weakened from a deteriorated EBITDA interest coverage ratio below 2.5x or an unexpected shortening of interest-rate fixing. We

could also lower our ratings if liquidity deteriorated, for example, if liquidity sources persistently fell below 1.05x of liquidity uses. However, since the average interest rate of Willhem's debt portfolio is likely to decrease and given management's decision to lengthened interest-rate fixing, we believe the risk of such events occurring is limited.

Willhem AB (publ) Financial Statistics

(Mil. SEK)	--Fiscal year ending Dec. 31 --				
	2015	2016	2017bc	2018bc	2019bc
Revenues	1,375	1,546	1,999	2,239	2,436
EBITDA	615	674	885	989	1,111
Operating income	2,371	2,249	2,648	2,130	2,420
Net income from continuing operations	1,832	1,692	1,962	1,569	1,732
Interest expense	234	246	307	350	379
Funds from operations	381	430	578	639	732
Capital expenditures	1,052	4,076	6,083	3,542	3,177
Total assets	18,065	28,103	34,146	37,088	41,087
Debt	9,420	17,125	21,206	22,579	24,846
Equity	7,386	9,078	11,040	12,609	14,341
EBITDA margin (%)	44.7	43.6	44.2	44.2	45.6
EBITDA interest coverage (x)	2.6	2.7	2.9	2.8	2.9
Operating cash flow/debt (%)	5.9	4.2	3.5	3.9	3.7
Debt/EBITDA (x)	15.3	25.4	24.0	22.8	22.4
Debt/debt and equity (%)	56.1	65.4	65.8	64.2	63.4

The data and ratios above result in part from S&P Global Ratings' own calculations. The main sources are the financial statements and budgets, as provided by the issuer. SEK--Swedish krona. bc--Base case, reflects S&P Global Ratings' expectations of the most likely scenario.

Related Criteria And Research

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - August 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers - December 17, 2014
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Ratings List

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

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