

Research Update:

Willhem AB Outlook Revised To Stable On Stabilizing Credit Metrics; 'A-/A-2' Ratings Affirmed

December 10, 2024

Rating Action Overview

- Swedish private housing company Willhem AB (publ)'s S&P Global Ratings-adjusted debt-to-debt-plus-equity decreased to 55.6% over the 12 months ended Sept. 30, 2024, from 58.1% the previous year, while its EBITDA interest stabilized at about 2.1x (for the rolling 12 months) over the past few quarters.
- We anticipate that Willhem's credit metrics will remain broadly stable under our assumption of flat fair value adjustment and improving funding costs, staying comfortably within our 'A-' rating thresholds over the next 12-24 months with debt to debt-plus-equity well below 60% and an EBITDA coverage ratio sufficiently above 1.8x.
- We therefore revised our outlook to stable from negative 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 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 3.0%-5.0% in 2025 and 2.0%-2.5% in 2026. We also anticipate that the company's S&P Global Ratings-adjusted EBITDA interest coverage will stay at about 2.2x-2.4x and debt to debt-plus-equity remain at about 55%-56% over the next 12-24 months.

Rating Action Rationale

We forecast that adjusted EBITDA interest coverage will remain around 2.2x-2.4x over the next 12-24 months (versus 2.1x as of third-quarter 2024), due to improving funding costs and a growing EBITDA base, maintaining sufficient headroom under our downside ratings threshold of 1.8x. Willhem's EBITDA interest coverage increased to 2.1x as of Sept. 30, 2024, from 2.0x in the second quarter of 2024 as a result of slightly lower funding costs (average cost debt was 2.6% in the third quarter versus 2.7% in second-quarter 2024) and higher earnings generation from operations.

Primary contact

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

Secondary contact

Marie-Aude Vialle
Paris
33-6-15-66-90-56
marie-aude.vialle
@spglobal.com

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We believe that the company's exposure to floating rate debt and high refinancing needs over the next two years will allow the capital structure to more rapidly adjust to the changes in interest rates compared with some European rated real estate peers with longer average debt maturity profiles and long fixed-rate terms. Willhem's loan portfolio includes an average fixed-interest rate term of 3.3 years and about 29% of these mature in the next 12 months. In addition, the company's exposure to pure floating-rated debt (related to commercial paper) is about 15%, which immediately affects funding costs.

In addition, we forecast that the company's EBITDA benefits from rental growth (as we understand the outcome of Tenant's Union annual negotiations so far resulted in an expected 4%-5% rent increase for 2025) as well as contribution from completion of project development of residential premises.

Therefore, we forecast an overall improved debt-service capacity over the next 12-24 months, leading us to anticipate that S&P Global Ratings-adjusted EBITDA interest coverage will slightly increase to around 2.2x-2.4x in 2025 and 2026 allowing for sufficient headroom at the current rating level.

Willhem's debt-to-debt-plus-equity ratio will likely remain around 55% in 2025-2026 amid a SEK2.6 billion capital increase from the state-owned pension fund AP1 over the past year and under our assumption of stable property valuations. On Sept. 30, 2024, S&P Global Ratings-adjusted debt to debt-plus-equity stood at 55.6% versus 58.1% on Sept. 30, 2023, and compared with 57.6% at year-end 2023. Even though leverage ratios were negatively affected by an 8.5% portfolio devaluation in 2023 followed by another 1.5% decline in the first three quarters of 2024, this has been addressed by three capital injections from its shareholder, state-owned AP fund 1, of a total amount of SEK2.6 billion over the past 12 months, partially offsetting the pressure on leverage.

We understand that Willhem is committed to its current financial policy, targeting a reported loan-to-value (LTV) ratio below 60% (50.5% as of third-quarter 2024). Also, we view positively the company's efforts over the past two years to preserve capital and strengthen the balance sheet under challenging market conditions. For instance, it cut dividends to zero in 2023 in 2024 and used the flexibility in its project portfolio to delay some expansion plans.

In our current base case, we expect S&P Global Ratings-adjusted debt-to-debt-plus equity ratio to be 54%-56% in 2025 and 2026, including our assumptions of flat fair value adjustments over the same time horizon. In addition, we expect the company to resume dividend payments in 2026 and thereafter. Should market conditions improve we could expect higher investments, which could put pressure on leverage metrics, but we believe the ratio will remain well below our downside threshold of 60%, given management's intention to fund capital expenditure (capex) and acquisitions with a mix of debt and equity.

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 nine months of 2023, the company reported 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 about 97%-99%. Over the next 12 months, we anticipate that Willhem's operating performance should be broadly unchanged, with the EBITDA margin remaining at

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60%-62%, where EBITDA growth from rent indexation and completed projects may be offset by increased costs as inflation is slowing (CPI of 1.6% in October 2024)

Our rating on Willhem now incorporates a one-notch downward adjustment for the capital structure, reflecting its shorter debt maturity (2.3 years as of fourth-quarter 2023) below our requirement of three years. Willhem's average debt maturity profile at 2.3 years as of third-quarter 2024 is relatively short compared with other rated real estate peers in Europe, and below our three-year requirement for the real estate sector. Willhem's short debt maturity reflects high refinancing needs over the short to medium term, mainly related to high usage commercial paper, representing about 15% of interest-bearing debt. In addition, around one-third of the loan portfolio is due on a yearly basis. This is also because Willhem, unlike some other Nordic real estate players that we rate (such as Hemsö or Balder), relies exclusively on the Swedish capital markets to fund itself, in which tenors for bonds are typically no longer than three to five years. That said, we notice that over the past few years and under challenging market conditions, Willhem has maintained access to the debt capital market, being able to roll over short-term debt. In addition, we recognize that the commercial paper program is fully backed by a guarantee from owner AP1. Given its reliance on the Swedish capital markets, Willhem's average debt maturity is likely to remain around 2.3-2.5 years, below our three-year requirement for the sector. We reflect this in our rating with a one-notch downward adjustment for capital structure. Given its strong track record at refinancing its capital structure over recent years, our analysis does not anticipate that average debt maturity will fall below two years.

We no longer apply a negative comparative rating analysis modifier. We have removed our negative comparable rating analysis modifier as we now view Willhem's leverage metrics more toward the middle of our "significant" financial risk profile category. We expect the company's to maintain debt-to-debt-plus-equity around 55%, in the middle of the 50%-60% range for the category. Even though Willhem is at the weaker end in terms of scale and geographic diversity compared with some other rated residential real estate peers with the same business risk assessment, we also consider the resilience of the regulated residential sector in which Willhem operates. This is evident in sustained high occupancy rate of 97%-99% over the past few years including during the pandemic and a period of a sharp increase of interest rates.

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 and has no intention to divest the holding. We expect AP1 to continue to support Willhem in persevering a sound capital structure and adhering to stated capitalization targets for Willhem. Moreover, Willhem holds a contractual agreement whereby AP1 commits to subscribe to commercial paper of up to SEK8 billion and we understand that financial covenants in Willhem's loan agreements indicate that AP1 is committed to remaining Willhem's majority shareholder. We therefore continue to incorporate a three-notch uplift for group support in our rating on Willhem, as per our methodology. AP1's equity injections over the past 12 months also support this view.

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 2%-4% annually in the next 12-24 months. We

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also anticipate that the company's S&P Global Ratings-adjusted EBITDA interest coverage will remain at about 2.2x-2.4x and debt to debt-plus-equity at about 55% over the next 12-24 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, or pushing its average debt maturity below two years.
- 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 raise the rating on Willhem if:

- EBITDA interest coverage improves to comfortably above 3.0x;
- Debt to debt-plus-equity is below 50%;
- Debt to EBITDA improves well below 13x;
- Access to capital markets for refinancing remains reliable; and
- The shareholder's strategy and commitment toward the company is unchanged.

Company Description

Willhem is one of the largest private housing companies in Sweden, owning a property portfolio of a value of SEK57.0 billion (€5.6 billion) as of third-quarter 2024. The portfolio comprises around 29,415 apartments across Sweden, enjoying a high total occupancy of 97.1% for the entire property portfolio (97.7% for the residential housing), while generating an annual rental income of SEK2,976 million.

The company focuses its operations on high-growth regions, currently owning and managing properties in 13 growth cities located between the three largest cities in Sweden (Stockholm, Gothenburg, and Malmö) with headquarters in Gothenburg. The Swedish rental markets is 100% regulated, and the rents are set through negotiations between tenant associations and the landlords. All participants, public and private, must adhere these rules.

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

Our Base-Case Scenario

Assumptions

- A contraction of real GDP in Sweden of 0.3% in 2024, then growth of 2.3% in 2025 and 2.5% in 2026. We project consumer price index growth of 1.9% in 2025 and 1.8% in 2026. Unemployment rates of 8.3% and 8.2% expected for Sweden over the same period.
- Annual like-for-like rental growth of 3%-4% in 2025 and 2%-3% in 2026, based on yearly negotiations and stemming from some rent uplift because of refurbishment.
- A sustained high occupancy rate of 97%-99% in the next 12-24 months, reflecting strong demand for regulated residential assets.
- Capex of SEK1.1 billion in 2025 and about SEK0.5 billion in 2026.
- Forecast portfolio acquisitions of about SEK1.1 billion in 2024 and SEK750 million in 2025, in line with company forecasts.
- Steady EBITDA margins of 60%-62% over the next few years, as increased costs are offset by higher rents and efficiency enhancement.
- Like-for-like portfolio valuation of -2% in 2024, while we expect a flat fair value adjustments thereafter.
- No dividends in 2025 but SEK500 million from 2026.
- Average cost of debt of 2.75% in 2025 and 2.7% in 2026.

Key metrics

Willhem AB (publ)--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026
(Mil. SEK)	2020a	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	2,374	2,491	2,664	2,860	3,018	3,244	3,367
EBITDA	1,408	1,458	1,604	1,761	1,859	2,011	2,105
Funds from operations (FFO)	969	1,021	1,136	954	992	1,140	1,179
Interest expense	413	406	516	825	866	871	926
Cash flow from operations (CFO)	898	1,121	1,194	795	1,010	1,152	1,203
Capital expenditure (capex)	1,396	1,725	1,966	1,605	627	490	900
Dividends	--	501	501	--	--	--	500
Debt	24,314	27,054	30,203	30,197	29,334	29,418	29,748
Equity	17,979	24,759	25,574	22,265	23,662	24,637	25,155
Adjusted ratios							
EBITDA margin (%)	59.3	58.5	60.2	61.6	61.6	62.0	62.5
EBITDA interest coverage (x)	3.4	3.6	3.1	2.1	2.1	2.3	2.3
Debt/EBITDA (x)	17.3	18.6	18.8	17.1	15.8	14.6	14.1
Debt/debt and equity (%)	57.5	52.2	54.1	57.6	55.4	54.4	54.2

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 on Sept. 30, 2024, includes:

- Unrestricted cash balance of SEK1.9 billion;
- The undrawn committed revolving credit facility of SEK15.8 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-SEK1.3 billion.

We assess liquidity uses from the same date as:

- Short-term debt maturities, including commercial paper, of SEK10.2 billion;
- Committed capex of about SEK875 million; and
- No dividends in 2025, but around SEK500 million from 2026.

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% (50.5% as of Sept. 30, 2024),
- An interest coverage ratio above 1.7x (2.2x as of Sept. 30, 2024).

Environmental, Social, And Governance

Environmental, social, and governance factors are an overall neutral consideration in our credit rating analysis of Willhem. The company aims a 50% reduction of its energy consumption by 2030 (from the 2013 base level of 173 kWh/sqm). Willhem targets to achieve climate neutrality by 2030 for its scope 1 and 2 emissions and reduce its scope 3 emissions by 50% over the same timeframe compared with 2018. The main environmental risks we assess for the company relate to carbon emissions and waste related to project development and Willhem sees significant potential for improvement in this area. Willhem's green bond framework was independently assessed by Cicero, now part of S&P Global Ratings. Cicero assigned Willhem's green bond framework a Medium Green shading and the company had secured green financing of about 59% of its total interest-bearing debt as of Sept. 30, 2024

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.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Sept. 30, 2024, Willhem's capital structure included SEK30.8 billion of reported debt, of which about 20% pertains to unsecured bonds, 29% unsecured green bonds, 35% traditional bank loans, and 15% commercial paper.

Analytical conclusions

The company's ratio of secured debt to total assets was about 14.8% as of Sept. 30, 2024, and thus below our threshold of 40%. Therefore, we align our issue ratings on the company's senior unsecured bonds with our long-term issuer credit rating at 'A'.

Rating Component Scores

Rating Component Scores

Rating Component Scores	
Component	
Foreign currency issuer credit rating	A-/Stable/A-2
Local currency issuer credit rating	A-/Stable/A-2
Business risk	Strong
Country risk	Very Low Risk
Industry risk	Low Risk
Competitive position	Strong
Financial risk	Significant
Cash flow/leverage	Significant
Anchor	bbb
Diversification/portfolio effect	Neutral/Undiversified
Capital structure	Negative
Financial policy	Neutral
Liquidity	Adequate
Management and governance	Neutral
Comparable rating analysis	Neutral
Stand-alone credit profile	bbb-
Entity status within group	Strategically important (+3 notches from SACP)

Related Criteria

- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024

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- 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 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings list

Ratings Affirmed; Outlook Action

	To	From
Willhem AB (publ)		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2

Ratings Affirmed

Willhem AB (publ)		
Issuer Credit Rating		
Nordic Regional Scale	--/--/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.spglobal.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://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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