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Ratings

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Summary:
Akelius Residential Property AB

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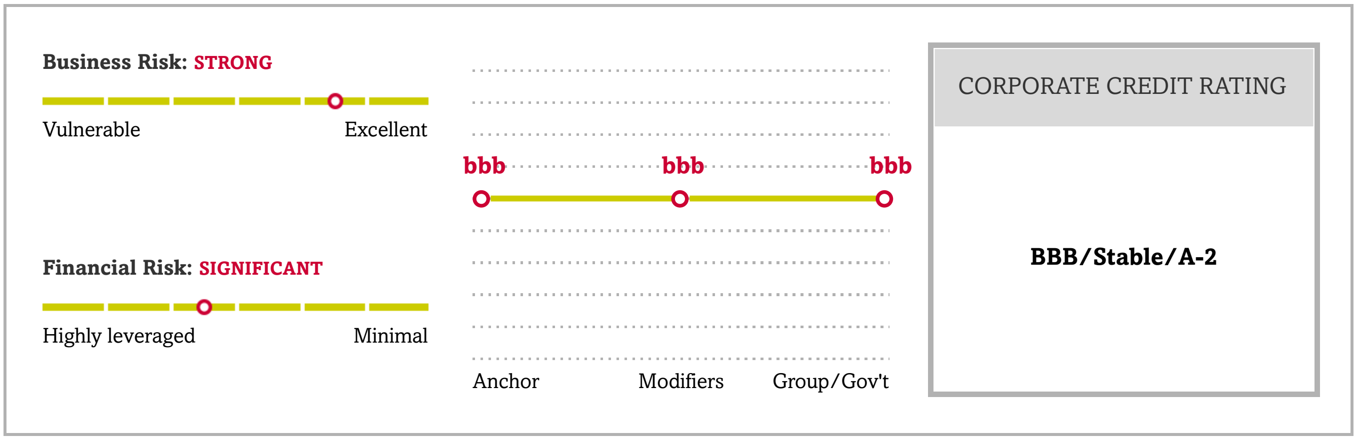

Rationale

Business Risk: Strong	Financial Risk: Significant
• Globally well-diversified income-producing property portfolio with real estate in large metropolitan cities where demand outpaces supply and real estate prices are rising. • Large asset portfolio of approximately Swedish krona (SEK) 105 billion (approximately €10.6 billion), spread across 47,000 apartments with a large tenant base. • Strong operational track record, with like-for-like rental income growth of 5.1% in 2017, as well as a high and stable occupancy rate of about 99%, excluding vacant premises for renovation purposes.	• Relatively high debt to debt plus equity compared to peers at the same rating level, at about 50% to 55% including our adjustments for preference shares. • Relatively low EBITDA interest coverage compared with peers, at about 1.6x, as a result of the low-yield environment and prime residential assets, as well as a relatively high cost base and our treatment of the preference shares as 50% debt. • Good access to bank financing and capital markets.

Outlook: Stable

The stable outlook on Swedish residential real estate company Akelius Residential Property AB reflects our expectation of continued favorable demand for midsize residential apartments in most of Akelius' markets, where supply remains limited. We also anticipate that Akelius will maintain stable leverage, with our adjusted ratio of debt to debt plus equity remaining less than 55%.

Downside scenario

We could lower the rating if Akelius' leverage increases, with debt to debt plus equity well above 55%, as a result of increasing operational costs or debt-funded acquisitions, or if EBITDA interest coverage falls to 1.5x or below. This could result from further material disposals or an increase in the cost structure, reducing the overall EBITDA base.

Upside scenario

We would raise the rating if Akelius sustainably improved its EBITDA interest coverage ratio close to 2.4x or above and its ratio of debt to debt plus equity to below 50%, including our adjustments for preference shares. This could result from strong rental income growth from renovated or newly acquired properties while related operating costs remain stable.

Our Base-Case Scenario

Assumptions

- Annual like-for-like rental income growth of at least 3% in 2018 and 2019, linked to our macroeconomic expectations in Akelius' main markets. We forecast real GDP growth in 2018 of 2.7% in Sweden and 1.7% in Germany, as well as low indexation (1.7% in Sweden and 1.8% in Germany for 2018), but some stronger renegotiated increases of existing rents, thanks to apartment upgrades and stable occupancy.
- Some increase in capital expenditures (capex), including maintenance, due to an enlarged portfolio size and higher renovation plans on newly acquired assets (such as in Canada, the U.S., and Denmark) that are likely to be renovated, in line with Akelius' operating strategy.
- Net buyer position for 2018 with a balanced mix of equity and debt funding.
- Stable average cost of debt of approximately 2.6%.

Key Metrics

	2017A	2018E	2019E
EBITDA (mil. €)	2,220	2,400-2,500	2,600-2,700
EBITDA/interest (x)*	1.6	1.7	1.6-1.7
Debt to debt plus equity (%)*	52.4	~54	~54

*Including S&P Global Ratings' adjustments. A--Actual. E--Estimate.

Company Description

Akelius is a Sweden-based real estate company, focusing on holding residential assets. As of Dec. 31, 2017, the company's portfolio comprised about SEK105 billion (about €10.6 billion) of properties located in 15 metropolitan cities, such as Berlin (22%), Stockholm (20%), Hamburg (8%), and London (7%). The company's strategy is long-term ownership of residential properties, with focus on large metropolitan cities with good growth prospects.

Akelius is a privately owned company, founded in 1994.

Business Risk: Strong

The rating is supported by Akelius' large and well-diversified residential property portfolio, with exposure to real estate markets where demand remains strong and new supply is limited. Compared with other rated residential peers with the same business risk assessment, Akelius is one of a few residential property companies that is diversified globally. Its portfolio of about SEK105 billion (approximately €10.6 billion) as of Dec. 31, 2017, is spread across locations and countries where the population is growing and one- to two-person households are increasing, such as Berlin (22% of total asset value), Stockholm (20%), London (7%), and New York (6%). Over 80% of the portfolio consists of assets situated in prime locations with good infrastructure that are within 5-10 km from city centers. Akelius recently extended its geographic reach with investments in the U.S. (New York, Boston, and Washington D.C.) and Denmark, together currently representing 20% of total portfolio exposure.

In addition, we think that Akelius has broad asset and tenant diversity, with over 47,000 units. Asset quality appears average to good, and we estimate that the company has modernized approximately 42% of its apartments in recent years. We view positively the company's strategy of long-term ownership of residential properties with no development activities. The average apartment size is 62 square meters, which is well in line with what we observe for other rated residential players in its markets.

In our view, Akelius has a positive operational track record with like-for-like rental income growth of 5.1% in 2017 and a very strong occupancy rate of about 99%, excluding vacant premises for renovation, as of Dec. 31, 2017. In Germany, England, and France (together over 40% of the portfolio), Akelius is able to transfer utility costs to the tenant. However, compared with the above-mentioned regions, rising utility costs may not be fully covered by tenants in countries such as Sweden and Canada. Taking into account the declining portfolio share in Sweden over recent years, as a result of disposals, the overall profitability should not be diminished. We expect like-for-like rental income growth will remain above 3% as a result of Akelius' index-linked rental agreements and the benefit of its renovation and apartment upgrades. We understand that about 88% of Akelius' rents are below market level.

Despite the benefits we see from Akelius' global diversity, we believe that the company can achieve only limited economies of scale in some of its markets compared with its rated peers in the residential segment who focus more on single countries and regions. Although we expect that the company's maintenance expenses will remain stable relative to portfolio size, renovation and refurbishment expenditures are much higher than peers' and will increase further along with the portfolio's size and Akelius' strategy to acquire assets with upgrade potential.

Peer comparison

Table 1

Akelius Residential Property AB--Peer Comparison					
	Dec. 31, 2017				
(Mil. SEK)	**Akelius Residential Property AB**	**Deutsche Wohnen SE**	**Vonovia SE**	**Grand City Properties SA**	**Fastighets AB Balder**
Revenues	4,122	8,499	16,898	4,863*	5,915
EBITDA	2,220	5,429	11,084	2,437	3,741
Funds from operations	793	3,936	7,957	1,647	2,382
Interest expense	1,403	1,183	3,203	514	1,137
Net income from continuing operations	7,721	16,881	23,688	5,253	7,118
Cash flow from operations	842	5,113	6,486	1,401	2,374
Capital expenditures	2,777	2,235	10,249	716	3,745
Dividends paid	8,206	2,634	3,086	979	17
Cash and short-term investments	155	3,574	2,259	3,945	1,585
Debt	49,913	68,108	145,426	27,102	55,612
Equity	45,260	100,336	162,539	34,556	39,441
Debt and equity	95,173	168,444	307,965	61,658	95,052
Valuation of investment property	102,242	196,063	319,878	62,655	98,360
Adjusted ratios					
Annual revenue growth (%)	0.3	11.7	8.7	13.6	10.1
EBITDA margin (%)	53.9	63.9	65.6	50.1	63.2
Return on capital (%)	2.3	3.1	2.4	4.2	5.0
EBITDA interest coverage (x)	1.6	4.6	3.5	4.7	3.3
Debt/EBITDA (x)	22.5	12.5	13.1	11.1	14.9
Debt/debt and equity (%)	52.4	40.4	47.2	44.0	58.5

SEK--Swedish krona. *Gross rental income (warm rent).

Financial Risk: Significant

Akelius' financial risk profile is characterized by moderate debt leverage, in our view. Debt to debt plus equity stood at 52.4% as of Dec. 31, 2017, including our adjustments for preference shares. The company recently decreased leverage, following its position in 2016 as a net seller of noncore assets outside metropolitan cities, the repayment to its shareholder of the SEK2 billion hybrid bond, which we viewed as full debt. The ratio also benefits from equity issuances and a significant upward portfolio revaluation in 2017.

The rating also incorporates the company's weak EBITDA interest coverage ratio of 1.6x as of Dec. 31, 2017, relative to rated residential real estate peers. This is due mainly to Akelius operating in a low-yield environment with prime assets, our view of a higher cost structure than peers', and our assessment of its preference shares as having intermediate equity content, with 50% of its dividend payments going to preferred shareholders as interest expense. We still expect the ratio of EBITDA interest coverage to gradually strengthen to 1.7x in the next 12-24 months, thanks to refinancing activities in 2017, with the cost of debt having improved to 2.58% (from 2.62% in 2016).

Furthermore, since we classify the company's preference shares and its recently proposed hybrid bond as having intermediate equity content, we treat 50% of the principal outstanding and all related payments, including accrued dividends under the preferred stock and the hybrid instrument, as debt and 50% as equity (see "Real Estate Company Akelius Residential Property AB's Proposed Unsecured Subordinated Hybrid Notes Assigned 'BB+' Rating" published March 14, 2018).

We understand that the company is committed to keeping hybrid capital, including preference shares, below 15% of total capitalization, which is our threshold for assessing equity content of hybrid instruments. We would revise our assessment regarding the equity content of the preference shares if this commitment changes or our view of permanence or deferability weakens.

Financial summary

Table 2

Akelius Residential Property AB--Quarterly Data					
RTM	**Dec. 31, 2017**	**Sept. 30, 2017**	**June 30, 2017**	**March 31, 2017**	**Dec. 31, 2016**
(Mil. SEK)					
Revenues	4,122	4,173	4,284	4,374	4,109
EBITDA	2,220	2,195	2,225	2,230	2,217
Funds from operations	793	826	812	772	673
Interest expense	1,403	1,367	1,375	1,408	1,485
Net income from continuing operations	7,721	9,746	10,592	11,384	10,187
Cash flow from operations	842	328	459	365	551
Capital expenditures	2,777	2,842	2,963	2,970	2,989
Dividends paid	8,206	8,016	7,991	4,926	5,233
Cash and short-term investments	155	1,100	74	136	137
Debt	49,913	45,436	43,043	43,304	43,052
Equity	45,260	42,766	41,555	38,355	36,004
Debt and equity	95,173	88,202	84,598	81,659	79,056
Valuation of investment property	102,242	97,116	90,395	90,477	84,634
Adjusted ratios					
EBITDA margin (%)	53.9	52.6	51.9	51.0	54.0
Return on capital (%)	2.3	2.5	2.6	2.7	2.8
EBITDA interest coverage (x)	1.6	1.6	1.6	1.6	1.5
Debt/EBITDA (x)	22.5	20.7	19.3	19.4	19.4
Debt/debt and equity (%)	52.4	51.5	50.9	53.0	54.5

RTM--Rolling twelve months. SEK--Swedish krona.

Liquidity: Adequate

We assess Akelius' liquidity as adequate, supported by our forecast that the company's liquidity sources will exceed its funding needs by about 1.3x over the next 12 months.

Our liquidity assessment is also supported by Akelius' positive track record of accessing equity and capital markets as well as its good relationships with banks globally.

We understand that Akelius has some covenants for its existing bond issuances and credit lines. We estimate that the headroom for these covenants is adequate--at more than 10%.

Principal Liquidity Sources	Principal Liquidity Uses
• Unrestricted cash and cash equivalents of about SEK170 million; • Our forecast of positive cash funds from operations of about SEK1 billion-SEK1.2 billion; • About SEK4.5 billion of undrawn and committed credit lines maturing in more than 12 months; and • Approximately SEK2.5 billion of contracted asset sales post-reporting period.	• About SEK3.1 billion of short-term debt maturities, including amortization from Akelius' bank loans; • About SEK500 million of capex, estimated as required minimum spending for the next 12 months; • Approximately SEK376 million of dividends, related to preference shareholders; and • About SEK2.4 billion of contracted portfolio acquisitions in Montreal, Stockholm, and New York.

Ratings Score Snapshot

Corporate Credit Rating

BBB/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:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Dec. 31, 2017, the company's capital structure comprises 41% secured debt and 59% unsecured debt. Unsecured bonds are issued under Akelius Residential Property AB.

Analytical conclusions

We assess the issue ratings on the company's senior unsecured bond at 'BBB', in line with the issuer credit rating. This is because the company's exposure to secured debt is limited (secured debt to total assets is approximately 18%).

Related Criteria

- Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Related Research

- Real Estate Company Akelius Residential Property AB's Proposed Unsecured Subordinated Hybrid Notes Assigned 'BB+' Rating, March 14, 2018).

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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