FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Akelius's IDR at 'BBB'/Stable; Senior Unsecured Rating at 'BBB+'

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Fitch Ratings - Stockholm - 22 Mar 2022: Fitch Ratings has affirmed Akelius Residential Property AB's (Akelius) Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook and senior unsecured rating at 'BBB+'. A full list of ratings is below.

The ratings reflect Akelius's EUR6 billion quality residential-for-rent property portfolio and the stability of its rental cash flows, combined with a significant net cash position after receipt of 4Q21 disposal proceeds. Fitch expects Akelius to retain a conservative financial profile in favour of unsecured debtholders as it completes its retained portfolio's ongoing renovation projects and gradually reinvests in residential property acquisitions in developed markets (US, Canada and Europe). The company plans to pay a EUR2.0 billion net dividend to its foundation owners in 2022.

The re-investment period may last several years, depending on market conditions and management's preference for buying properties individually ('cherry-picking') rather than in large portfolios. In the meantime, Akelius has placed its excess liquidity into investment-grade bonds with maturities matching (ahead of) its debt, and plans to use cash to repay maturing debt.

KEY RATING DRIVERS

Portfolio Focused on North America: The retained property portfolio comprises EUR6 billion of properties in six cities in the US (40% of end-2021 portfolio value) and Canada (36%), as well as London (16%) and Paris (7%). The portfolio includes several renovation projects, which is reflected in a high YE21 12.5% vacancy. This follows the sale of its more mature and low vacancy German and Scandinavian residential assets. Akelius plans to materially reduce the remaining portfolio's vacancy rate during 2022 and 2023 by completing its renovation projects (France, US, Canada), increasing the group's rental income.

Partially Regulated Markets: The shift towards North American residential markets has reduced the share of the group's regulated rental income. However, 64% of Akelius's portfolio is still subject to some form of rent regulation and one-third of properties have below-market rents. Rental increases are often index-linked for in-place rents and there are protections for existing tenants. This is reflected in the low tenant turnover, which was 27% during 2021, compared with US peers' portfolios higher tenant churn at around 50%.

European Portfolio Mindset: Akelius's business profile benefits from its focus on assets with reversionary potential, index-linked rental growth and resultant low tenant churn, reflecting its European residential portfolio mindset. The US and Canadian assets also have low income yields with high income stability. Furthermore the group's lower dividend requirement, stemming from its non-REIT status and supportive charitable owners, allows it to retain more capital across the property cycle.

Resultant Change in Rating Sensitivities: With the 4Q21 disposal of the lower-risk German and Swedish regulated residential assets, Fitch has reduced the group's debt capacity implied in the Rating Sensitivities for the US and Canada portfolio, which has greater exposure to free market rents, while acknowledging the stability of Akelius's specific local markets and the portfolio's reversionary potential.

Extended Growth Strategy: Management plans to grow the property portfolio back to around 50,000 residential units (2021: 17,770 units) by investing in existing and potentially new markets. Akelius's strategy is to acquire properties by selectively cherry-picking assets in the right location, with less renovation potential than historically. We believe this will be the main avenue of growth, although some larger acquisitions cannot be ruled out. Acquisitions could also include deals with property developers for Akelius to acquire new-build stock. Acquisitions will initially be funded by using YE21 disposal proceeds. Acquired properties are expected to have higher income yields than assets sold in 2021.

Conservative Leverage: Fitch expects Akelius to maintain a conservative financial profile while it reinvests proceeds into new properties. At end-2021, Akelius had EUR6.3 billion of cash and marketable securities, which resulted in a net cash position compared with its EUR4.2 billion of remaining (mostly unsecured) debt and EUR1 billion of hybrids. Akelius plans to pay out EUR2 billion in extraordinary (net) dividends during 2022 to its foundation shareholders and use part of its cash to repay maturing debt.

Placement of Excess Liquidity: Management has placed Akelius's excess liquidity in investment grade bonds (A+ rated on average) with a mix of currencies (Swedish krona, euro, sterling and US dollars). Maturities has been selected to be ahead of the group's debt maturities to be able to use proceeds for debt repayment if needed.

ESG-Corporate Governance: Akelius has an ESG Relevance Score of '4' for corporate governance as it remains privately-held by the Akelius Charitable Foundations and by a small share of public ownership in the form of dividend-focused class D shares with lower voting rights. Ownership concentration and an influential founder have not had a negative impact on its governance record, which has remained satisfactory. Transparent quarterly reporting is available. Akelius' board comprises two independent and three dependent members.

DERIVATION SUMMARY

Akelius's portfolio comprises EUR6 billion of residential properties in metropolitan cities in Canada, US, UK and France. Fitch expects the portfolio to materially grow as disposal proceeds are deployed into additional assets. We expect Akelius's portfolio is currently smaller than Heimstaden Bostad AB (IDR: BBB/Stable, EUR30 billion) pan-European portfolio, and Annington Limited's (IDR: BBB/Stable, EUR9 billion), but larger than Grainger Plc's (IDR: BBB-/Stable, EUR3.5 billion), both in the UK, and Peach Property Group AG's (IDR: BB/Stable, EUR2 billion), located mainly in the North Rhine-Westphalia region of Germany.

Fitch forecasts Akelius will gradually reinvest its net cash position into investment property in developed markets. We expect Akelius's leverage to increase in the coming years as proceeds are deployed but remain conservative compared with its highly leveraged peers.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Rental growth primarily driven by a reduction of vacancy by completing renovation projects during 2022 and 2023, a modest indexation and rental uplifts on tenant churn

- EBITDA margin improvements driven by lower non-recoverables because of improving occupancy rates, and the benefits of scale in its remaining cities

- Around EUR400-EUR500 million capex until 2024 for renovation, energy projects and existing properties, thus reducing vacancies in specific portfolios

- Conversion of cash, and amounts discounted as (Fitch-defined) readily available cash, into proceeds for acquisitions

- Around EUR 2 billion of acquisitions mainly in 2022 and 2023 at a 6% gross rental income

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Net debt/rental-derived EBITDA below 14x given the expected portfolio mix

- EBITDA net interest cover above 2.5x

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Net debt/rental-derived EBITDA above 16.5x

- EBITDA net interest cover below 1.75x

- The EMEA real estate sector senior unsecured debt instrument uplift may be removed if unencumbered investment property assets to unsecured debt are not restored to above 2.0x when disposal proceeds are deployed and the company is in a net debt position

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Abundant Liquidity: Akelius had EUR1.2 billion in cash and EUR5.1 billion of marketable securities at end-2021. This more than covered the EUR53 million debt maturities and the EUR2 billion expected net dividend to be paid in 2022. It also covers its EUR613 million debt maturities in 2023. Additionally, Akelius had EUR255 million of undrawn credit facilities, of which around EUR136 million is longer than 12 months and included in Fitch's liquidity calculation.

The group's average debt maturity fell to 4.5 years and the average interest rate was 1.51% at end-2021. Most of Akelius's assets (EUR5.3 billion) are unencumbered with limited secured debt. Fitch expects the unencumbered investment property asset cover (calculated on investment property only) to be restored to above 2x during 2022. At end-2021, the US portfolios' assets were not secured debt-funded.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Akelius Residential Property AB has an ESG Relevance Score of '4' for Governance Structure due to corporate governance (as described above in Key Rating Drivers), which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Akelius Residential Property Financing B.V.				
senior unsecured	LT	BBB+	Affirmed	BBB+

Akelius Residential Property AB	LT IDR BBB Rating Outlook Stable Affirmed	BBB Rating Outlook Stable
	ST IDR F2 Affirmed	F2
senior unsecured	LT BBB+ Affirmed	BBB+
subordinated	LT BBB- Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Akelius Residential Property AB	EU Issued, UK Endorsed
Akelius Residential Property Financing B.V.	EU Issued, UK Endorsed

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