Research Update:

# Residential Property Firm Akelius Outlook Revised To Stable From Negative On Sustained Low Leverage; Affirmed At 'BBB'

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## Rating Action Overview

- Akelius plans to continue repaying upcoming debt maturities through its €2.4 billion of available liquidity sources, while still tempering its investment pace, and should therefore have limited refinancing needs over the coming 24 months.
- As a result, we expect the company's EBITDA-interest-coverage ratio to improve and stabilize toward 2.4x and above over our forecast horizon, as the rise in its cost of debt will be moderate and gradual while we expect robust EBITDA. We also expect the company's debt to debt-plus-equity to remain quite low at less than 40% over the next 24 months.
- Consequently, we revised our outlook on Akelius Residential Property AB to stable from negative and affirmed our 'BBB/A-2' long and short-term issuer credit ratings on the company, as well as its existing issue ratings.
- The stable outlook reflects our expectation that the company's occupancy and like-for-like growth in rental income should remain robust, while its EBITDA-interest-coverage ratio should improve toward 2.4x over the coming 24 months as the company plans to reduce gross debt and moderate its investment pace.

## Rating Action Rationale

**Akelius' gross debt should continue declining over the coming 24 months, with limited refinancing needs, therefore reducing interest expense.** We expect the company's EBITDA-interest-coverage to improve toward 2.4x by 2023, and stabilize above that level over 2024-2025, which would be consistent with the current rating. As of Sept. 30, 2023, Akelius reported €2.2 billion of financial assets, on top of €107 million of cash and equivalents and about €42 million of undrawn bank lines maturing beyond the next 12 months. While Akelius previously planned to reinvest the proceeds from its 2021 asset disposal (about €9.0 billion of German and Scandinavian properties) into new assets, it has decided to moderate its investment pace over the coming 24 months, given current market volatility. As such, it plans to continue using its financial assets to repay any upcoming debt maturities and would therefore not need to issue any new debt facilities over the coming 24 months. Its gross debt has already declined to €4.0 billion at end-September 2023 from €5.2 billion at year-end 2021, under our calculations, and we expect it will decrease further to about €3.5 billion by year-end 2024 and €2.5 billion by year-end 2025. We understand the company's €2.2 billion of financial assets can be liquidated immediately and mostly include covered bonds and senior bonds, measured at fair value and therefore already reflecting current market volatility. Although this strategy would result in a much slower restoration of the company's cash flow generation than previously expected, this would be compensated by lower leverage.

**As part of its prudent financial policy, we forecast the company's net debt to net-debt-plus-equity will remain low over the coming 24 months, albeit increasing on the back of some investments and minor dividend payments.** We forecast the company's debt to debt-plus-equity on a net basis to stand at about 27%-29% in 2023, 30%-34% in 2024, and 32%-37% in 2025, comfortably below our thresholds for the rating. We forecast this ratio will increase over the medium term from its current 24.6% level (end-September 2023), although we understand Akelius would likely continue moderating its investment pace over the next 24 months. This is based on our assumption of about €250 million-€300 million of annual capital expenditure (capex) and dividends, as well as potential further like-for-like portfolio devaluation of about 10%-12% over 2023-2024, mainly because of expected yield expansion, and higher volatility in the U.S. and Canadian market portfolio values. According to the company's financial policy, its reported loan-to-value (LTV) ratio should remain below 35% (versus 45% before November 2022) which corresponds to S&P Global Ratings-adjusted debt to debt-plus-equity of about 45%.

**We believe Akelius' portfolio operating performance will remain robust, although we view the portfolio as less stable than before the 2021 transaction, given dependency on a smaller number of assets and unregulated markets.** Given the slowdown in the company's investment pace, over the next 24 months we do not expect it will restore its portfolio to a size comparable with that before the disposal (€14.2 billion end-September 2021 versus €6.1 billion as of end-September 2023). Further, the company's recent strong investment in the U.S., and hence its expanded geographical footprint, is offset, in our view, by lower profitability, given limited economy of scales versus some domestic residential real estate players, where EBITDA margins are well above 60% versus 45% at Akelius. As a result, we now view the company's business risk profile as satisfactory, compared with strong previously. In addition, the portfolio now focuses on unregulated rental markets which have demonstrated more volatility in portfolio valuations over 2022 and 2023 than most European markets. Akelius reported 9.8% portfolio devaluation for full-year 2022, including 15.9% in Washington D.C., 18.1% in New York City, and 13.9% in Boston. It reported 4.7% portfolio devaluation mostly driven by 7.2% in Washington D.C. and 8.0% in Montreal. In addition, the company's exposure to the U.S. and Canadian markets translates into a risk of currency swings (dollar translation into euro-denominated revenues and assets) for the company. Still, our assessment incorporates the company's exposure to large metropolitan cities which should continue generating high occupancy rates over the coming 24 months (98.6% at end-September 2023).

**We believe Akelius' overall credit quality will remain comparable with those of issuers rated 'BBB', as reflected in our positive adjustment for our comparable ratings analysis.** Overall, we view the company's leverage as lower than most companies within the same "significant" financial risk profile category. This is based on Akelius' EBITDA interest coverage improving toward 2.4x in our forecasts, while we also expect the company to maintain a net debt to net-debt-plus-equity well below 50% over the coming two years.

## Outlook

The stable outlook reflects our expectation of continued favorable demand for residential assets in most of Akelius' markets, which demonstrate favorable demographic fundamentals. This should result in robust occupancy rates and like-for-like growth in rental income over the coming 24 months. We also forecast that the company will maintain relatively low leverage compared with other residential real estate peers, in line with its current favorable financial policy of maximum 35% reported-loan-to-value, while improving its EBITDA-interest coverage toward 2.4x over the coming 24 months.

### Downside scenario

We could downgrade Akelius over the next 24 months, if:

- EBITDA interest coverage was failing to improve well above 2.0x, in case of significant debt issuances with higher refinancing costs than currently expected, or in case of a decrease in occupancy rates or rental income generation; or
- Debt-to-debt-plus-equity was increasing close to 55% or above, on a prolonged basis, which could materialize in case of higher portfolio devaluations than currently anticipated, or material debt-funded acquisitions; or
- Debt-to-annualized-EBITDA was increasing well above 13x; or
- Its portfolio size was falling significantly or was demonstrating a high volatility in its operating performance.

### Upside scenario

We could upgrade Akelius' ratings over the next 24 months, if:

- Its portfolio was growing materially into resilient markets with strong fundamentals, and would become comparable to higher-rated peers; and
- EBITDA interest coverage improves toward 3.0x or above on a sustainable basis; and
- Debt to debt-plus-equity remains comfortably below 45% on a sustained basis; and
- Debt to annualized EBITDA was sustainably below 11x.

## Company Description

Sweden-based Akelius Residential Property AB is a privately owned real estate company, focusing on residential assets. As of Sept. 30, 2023, the company's portfolio stood at €6.1 billion with an average capitalization rate of 4.57%. The company focuses on long-term ownership of residential properties, particularly in large metropolitan cities with sound growth prospects and limited new supply, such as Toronto (20% of property value), Montreal (16%), London (16%), and Washington

(15%). In terms of countries, the company's assets are mostly in the U.S. (€2.5 billion), Canada (€2.2 billion) and in Europe (€1.4 billion) in London and Paris.

Akelius Foundation owns 84.02% of Akelius. The remaining shares are split between Hugo Research Foundation (9.63%), Grandfather Roger Foundation (4.82%), and institutional shareholders (5.5%; through issuance of D-shares in 2019).

## Our Base-Case Scenario

### Assumptions

- Consumer price index (CPI) in the U.S.: about 4.1% in 2023 (after 8.0% in 2022), slowing to 2.4% in 2024 and 1.9% in 2025.
- U.S. real GDP growth: about 2.3% in 2023, 1.3% in 2024, and 1.4% in 2025.
- In Canada, CPI of 3.9% in 2023 (after 6.8% in 2022), 2.2% in 2024, and 2.5% in 2025
- Canada's real GDP growth at 1.2% in 2023, 1.2% in 2024, and 1.5% in 2025.
- Positive annual like-for-like rental income growth of 8%-10% in 2023, after 11.5% in the nine months to Sept. 30 2023, reflecting the impact from high inflation in 2022 reflected through lease indexation, improving occupancy after the completion of renovation projects, and recovery from 2022 during which the company had to grant some rent concessions in the context of the pandemic. We assume 2%-3% growth over 2024, and 1%-2% over 2025, as indexation will be more limited.
- Potential further like-for-like portfolio devaluation of about 10%-12% over 2023-2024, mainly as a result of expected yield expansion, and given higher volatility of U.S. and Canadian market portfolio values.
- Slightly less than €200 million of capex in 2023, following €144 million in the nine months to Sept. 30 2023. We further assume about €100 million per year over 2024-2025, as we understand the capex program will likely decline over the next two years.
- No acquisitions assumed in 2023, and €100 million-€150 million of potential opportunistic acquisitions over 2024-2025, and no disposals expected over 2023-2025. Although we understand Akelius would likely opportunistically redeploy its capital into new properties over the medium term, we believe it will likely take longer than previously expected, due to current market volatility and uncertainties on real estate prices and valuations.
- Cash dividend of about €200 million in 2023, and about €150 million per year afterward. We understand the company does not plan any further exceptional dividends for the coming 24 months.
- Repayment of upcoming debt maturities over the next 24 months with available cash and liquidation of financial investments (€2.3 billion at the end of September 2023, including €107 million of cash).
- We conservatively assume a potential €200 million debt issuance in 2024 at a 7% refinancing rate.
- Average cost of debt to remain below 2% over 2023-2025 (excluding hybrids), only slightly increasing from 1.57% at end-September 2023, given limited immediate refinancing needs.

### Key metrics

Based on these assumptions, we forecast the following S&P Global Ratings-adjusted credit metrics:

- EBITDA-interest-coverage of 2.1x-2.3x in 2023, improving to 2.4x-2.7x in 2024, and 3.0-3.5x in 2025.
- Debt to debt-plus-equity of 27%-29% in 2023, 30%-34% in 2024, and 32%-37% in 2025.
- Debt to EBITDA of 11x-12x in 2023, 12x-13x in 2024 and 13x-14x in 2025.

## Liquidity

We assess Akelius' liquidity as adequate. This is based on our forecast that the company's liquidity sources will exceed its funding needs by more than 1.2x over the 12 months started Sept. 30, 2023.

Although we have included €1.5 billion of financial investments in our liquidity sources (conservatively excluding the €645 million of investment in Castellum from the company's total financial assets reported as of Sept. 30, 2023), we note that the company's liquidity would remain adequate over the next 12 months in a stress scenario where we would consider a haircut on these instruments of up to 60%).

Principal liquidity sources as of Sept. 30, 2023:

- Unrestricted cash and cash equivalents of about €107 million.
- About €1.5 billion of financial investments, excluding the company's stake in Castellum which accounted for €645 million reported as of Sept. 30, 2023. We understand these investments can be liquidated immediately and would be used to repay upcoming debt maturities, and they would mostly comprise senior bonds and covered bonds;
- About €42 million of undrawn and committed credit lines maturing in more than 12 months; and
- Our forecast of positive cash funds from operations of about €100 million-€110 million for the next 12 months.

Principal liquidity uses as of Sept. 30, 2023:

- About €605 million of contractual debt maturities over the coming 12 months;
- Our estimate of about €50 million of committed capex for the next 12 months; and
- No cash dividends as the company does not have a real-estate investment trust (REIT) status and related dividend payment requirement.

## Ratings Score Snapshot

| Issuer Credit Rating | BBB/Stable/A-2 |
|---|---|
| Business risk: | Satisfactory |
| Country risk | Very low |

| Issuer Credit Rating | BBB/Stable/A-2 |
|---|---|
| Industry risk | Low |
| Competitive position | Satisfactory |
| 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 | Positive (+1 notch) |

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

- Akelius Residential Property AB, May 16, 2023

## Ratings List

**Outlook Action; Ratings Affirmed**

| | To | From |
|---|---|---|
| **Akelius Residential Property AB** | | |
| Issuer Credit Rating | BBB/Stable/A-2 | BBB/Negative/A-2 |
| **Ratings Affirmed** | | |
| **Akelius Residential Property AB** | | |
| Issuer Credit Rating | | |
| Nordic Regional Scale | --/--/K-2 | |
| Senior Unsecured | BBB | |
| Subordinated | BB+ | |
| **Akelius Residential Property Financing B.V.** | | |
| Senior Unsecured | BBB | |