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Research Update:

Residential Property Firm Akelius Downgraded To 'BBB–' On Unexpected Proposed Exceptional Dividends; Outlook Stable

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Rating Action Overview

- On Nov. 27, 2023, Akelius announced a proposed exceptional dividend of €1.3 billion (related to class A ordinary shares) by transferring most of its available financial assets to its main shareholder, Akelius Apartments Ltd. The shareholder will provide a financial guarantee for up to €1.1 billion to refinance some of the company's upcoming debt maturities.
- We view this unexpected distribution as reducing the company's liquidity buffer and financial policy prudence, while also pushing its debt-to-EBITDA ratio to well above 13x.
- We therefore lowered our long-term credit rating on Akelius from 'BBB' to 'BBB-' and our short-term rating from 'A-2' to 'A-3'. We also lowered our Nordic regional scale short-term rating to 'K-3' from 'K-2'.
- The stable outlook indicates that we expect Akelius to continue benefitting from favorable demand for its residential assets, which should result in a robust operating performance, while its EBITDA-to-interest-coverage ratio should still improve to well above 1.8x and its debt-to-debt-plus-equity ratio will likely remain well below 60% over the next 24 months.

Rating Action Rationale

We view the company's exceptional dividend as reducing its financial prudence. The company announced a €1.3 billion exceptional dividend through a transfer of financial assets to its shareholder and will temporarily breach its own financial policy in 2023 (maximum 35% reported loan-to-value). This unexpected distribution makes the company's credit metrics less predictable, in our view, and diminishes the financial flexibility it had previously on its financial assets' use of proceeds.

Akelius' balance sheet will no longer comprise liquid short-term investments, pro forma the dividend, which will see its debt-to-EBITDA and debt-to-debt-plus-equity ratios deteriorate versus our previous assumptions. We previously expected the company would continue using all its financial assets to repay any upcoming debt maturities, in line with its public strategy. We therefore included its financial assets as short-term liquid investments (reported at €2.2 billion as of September 2023), which reduced its net debt. Following its use of around €200 million of these financial assets to repay debt, and the proposed €1.3 billion transfer via the exceptional dividend, Akelius' financial assets would be just its stake in Castellum (€645 million value as of September 2023). We no longer view this stake as liquid and available to repay debt (see our base-case scenario for more details) and therefore we would exclude it from our calculation of net debt. As a result, its S&P Global Ratings-adjusted net debt would rise from around €1.7 billion in our previous forecasts for end-2023 to around €3.7 billion. This results in debt to debt plus equity of 55%-56% in 2023, reducing gradually to below 50% over 2024-2025, and debt to EBITDA of 26x-27x reducing to 15x-21x over 2024-2025, with the company still planning to repay debt over the coming 24 months.

The dividend would reduce the company's liquidity cushion and our forecast EBITDA-to-interest-coverage ratio in 2025. In return for this dividend, the company would benefit from its main shareholder Akelius Apartments' commitment to inject €1.1 billion equity through a financial guarantee, the proceeds of which the company will use to repay upcoming maturities. That said, Akelius would have close to €1.7 billion in debt maturities over 2024-2025, including a €500 million bond due March 2024, a SEK1.0 billion bond due November 2024, a €600 million bond due February 2025, and a £400 million bond due August 2025. While the company could potentially liquidate its investment in Castellum over time to fund its debt maturities, we assume it would need to raise debt at higher costs than the current cost of debt (7% potential refinancing rate versus 1.57% average cost of debt). As a result, we expect its EBITDA-interest-coverage ratio to stand at 2.2x-2.6x in 2025, versus our previous forecast of 3.0x-3.5x, which is still commensurate with the current rating. In addition, we understand that the guarantee can only be used to repay Akelius' upcoming debt maturities, therefore reducing the company's financial flexibility to cover other financial obligations such as capital expenditure or investments in its property portfolio.

Outlook

The stable outlook reflects our expectation of continued good 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. Although we understand that, following the exceptional dividend, the company would temporarily breach its financial policy of maximum 35% reported loan to value, we expect it would maintain moderate leverage, including EBITDA to interest coverage well above 1.8x and debt to debt plus equity well below 60%.

Downside scenario

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

- EBITDA interest coverage was failing to improve to well above 1.8x, which could stem from significant debt issuances with higher refinancing costs than currently expected, or from a decrease in occupancy rates or rental income generation; or
- Debt to debt plus equity was increasing close to 60%, on a prolonged basis, which could result from higher portfolio devaluations than currently anticipated, or material debt-funded

acquisitions; or

- Debt to annualized EBITDA was deviating materially from our current forecasts, which could result from higher-than-currently-expected distributions to shareholders; or
- Its portfolio size was decreasing significantly or showing high volatility in its operating performance.

Upside scenario

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

- Debt to annualized EBITDA returns to sustainably below 13x; and
- EBITDA interest coverage improves to well above 2.0x or above on a sustainable basis; and
- Debt to debt plus equity remains comfortably below 55% on a sustained basis; and
- The company demonstrates a more prudent and predictable financial policy, while also moderating its distributions to shareholders; and
- Its portfolio showed strong operating performance, with portfolio values stabilizing.

Company Description

Sweden-based Akelius Residential Property AB is a privately owned real estate company, focusing on residential assets. As of Sept. 30, 2023, its portfolio stood at €6.1 billion with an average capitalization rate of 4.57%. The company focuses on the 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 Europe (€1.4 billion) in London and Paris.

Akelius Foundation, through its subsidiary Akelius Apartments Ltd., 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 the issuance of D-shares in 2019).

Our Base-Case Scenario

Assumptions

- We forecast the consumer price index (CPI) in the U.S. to be about 4.1% in 2023 (after 8.0% in 2022), slowing to 2.4% in 2024 and 1.9% in 2025.
- We expect U.S. real GDP growth at about 2.3% in 2023, 1.3% in 2024, and 1.4% in 2025.
- In Canada, we assume CPI of 3.9% in 2023 (after 6.8% in 2022), 2.2% in 2024, and 2.5% in 2025, and Canada's real GDP to grow 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 high inflation in 2022, lease indexation, improving occupancy rates after renovation projects complete, and recovery from 2022 when the

company had to grant some rent concessions amid the pandemic. We assume conservatively 2%-3% like-for-like rental income growth over 2024, and 1%-2% in 2025, as indexation will be more limited.

- Like-for-like portfolio devaluation of about 10%-12% over 2023-2024, mainly because of expected yield expansion, and given the higher volatility of U.S. and Canadian market portfolio values.
- Nearly €200 million in capex in 2023, following €144 million in the nine months to Sept. 30, 2023. We assume about a further €100 million per year over 2024-2025, as we understand the capex program will likely decline over the next two years.
- No acquisitions in 2023, and €100 million-€150 million of potential opportunistic acquisitions over 2024-2025, with no disposals expected over 2023-2025. Following the transfer of the financial assets to the direct parent company, we no longer think that Akelius will deploy its capital for material growth.
- Dividends of about €1.5 billion in 2023, including the €1.3 billion exceptional dividend announced on Nov. 27, through a transfer of financial assets to the shareholder, in addition to €189 million of cash dividends already distributed in the first nine months of the year, versus the €200 million we previously assumed. We assume about €150 million in cash dividends per year afterward. We understand the company does not plan any further exceptional dividends for the coming 24 months, although we have limited visibility on its dividend distributions.
- Equity contributions of around €598 million in 2024 and €518 million in 2025 from the company's main shareholder, through the €1.1 billion financial guarantee provided, the proceeds from which would be used to repay upcoming maturities.
- Potential gradual liquidation of the Castellum stake worth €645 million as of Sept. 30, 2023, during 2024-2026.
- Debt refinancing of around €100 million in 2024 and €600 million-€650 million in 2025 at around a 7% refinancing rate.

Key metrics

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

- EBITDA to interest coverage of around 2.1x in 2023, improving to 2.4x-2.7x in 2024, and 2.2x-2.6x in 2025.
- Debt to debt plus equity of 55%-56% in 2023, 47%-50% in 2024, and around 45% in 2025.
- Debt to EBITDA of 26x-27x in 2023, 20x-21x in 2024, and 15x-18x in 2025.
- Based on Akelius' audited annual accounts for 2022, we have updated one of our adjustments to its credit metrics. We used to consider its stake in Castellum as a liquid short-term investment, together with the company's other financial assets, thereby reducing its net debt. Based on a peers' comparison, we consider these shares to be less liquid than the other financial assets the company had on its books, so we now remove them from our net debt calculation. This adjustment results in the company's debt-to-debt-plus-equity ratio increasing to 27.7% for 2022, from 22.2%, and debt to EBITDA increasing to 13.7x, from 10.2x.

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 from Sept. 30, 2023. We note that its liquidity cushion materially reduces pro forma the exceptional dividend.

Principal liquidity sources as of Sept. 30, 2023, pro forma the exceptional dividend:

- About €250 million of cash and financial investments (pro forma the €1.3 billion exceptional dividend) including €107 million of unrestricted cash and cash equivalents. We understand these investments can be liquidated immediately and would be used to repay upcoming debt maturities, and mostly comprise senior bonds and covered bonds. We continue to exclude the stake in Castellum from these financial investments.
- About €42 million of undrawn and committed credit lines maturing in more than 12 months;
- Our forecast of positive cash funds from operations of about €90 million-€100 million for the next 12 months; and
- About €605 million drawn down from the financial guarantee to serve upcoming debt maturities as they become due.

Principal liquidity uses as of Sept. 30, 2023, pro forma the exceptional dividend:

- 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 real-estate investment trust (REIT) status and related dividend payment requirements.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
Business risk:	Satisfactory
Country risk	Very low
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	Negative (-1 notch)
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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Ratings List

Downgraded

	To	From
Akelius Residential Property AB		
Issuer Credit Rating	BBB-/Stable/A-3	BBB/Stable/A-2
Nordic Regional Scale	--/--/K-3	K-2
Senior Unsecured	BBB-	BBB
Subordinated	BB	BB+
Akelius Residential Property Financing B.V.		
Senior Unsecured	BBB-	BBB