20 June 2022 Corporates

Corem Property Group AB
Sweden, Real Estate

BBB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.5x	2.6x	2.4x	2.3x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	15.5x	27.9x	17.2x	16.1x
Loan/value ratio (%)	55%	52%	52%	52%

Rating rationale

Corem Property Group has had a busy last 12 months, dominated by the integration of Corem Kelly AB (previously Klövern AB; rated BBB-/Stable by Scope). Through the acquisition in June 2021, the company took over a property portfolio of 342 investment properties (about 2.5m sq m valued at SEK 62bn), broadened its range of property types, customers and geographies and took over a development portfolio. In November 2021 Corem signed a letter of intent with ALM Equity to create a joint venture management company that will develop and hold residential properties. In February 2022 the parties entered into a binding agreement under which Corem intends to transfer building rights and properties with a market value of SEK 5.4bn into the joint venture, resulting in a stake of just below 50% in June 2022.

Corem's business risk profile (assessed at BBB) is the primary driver of the rating, with around 500 properties in predominantly 'A' cities and a portfolio that is well balanced between office and logistics. A short weighted average unexpired lease term (WAULT) of 3.7 years and a relatively low occupancy rate of 90% constrain the rating. Both ratios are somewhat mitigated by their stability over the last five years. Corem's financial risk profile (assessed at BB+) is driven by historically strong debt protection, projected to remain above 2.2x, and a loan/value (LTV) ratio of 52% currently, both of which are forecasted to remain at similar levels.

Outlook and rating-change drivers

The Outlook is Stable and incorporates the successful integration of Corem Kelly AB, a modest growth strategy and an increased focus on reducing vacancies in the combined portfolio. It further incorporates our expectation of a stable LTV of around 52% and a Scope-adjusted EBITDA interest cover of above 2.2x. We also expect continued positive cash flow, as measured by Scope-adjusted free operating cash flow (FOCF).

A negative rating action would be possible if LTV reached above 60% on a sustained basis or Scope-adjusted EBITDA interest cover weakened below 2.2x. This could be driven by an increase in interest-bearing debt through heavily debt-financed acquisitions, or remortgaging amid a worsening economic or market sentiment that put real estate asset values under pressure and/or significantly reduced income while interest costs were high.

A positive rating action could be warranted if LTV stood at around or below 50% on a sustained basis. This could be driven by lower debt-funded capex, decreased debt needs through stronger-than-anticipated portfolio cash flows and improved market sentiment resulting in fair value appreciation.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
15 July 2021	New	BBB-/Stable

Ratings & Outlook

Issuer BBB-/Stable

Analyst

Thomas Faeh
+47 9305 3140
t.faeh@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2021

European Real Estate Methodology; January 2022

Scope Ratings GmbH

Karenslyst allé 53
N-0279 Oslo

Phone +47 2162 3142

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Medium-sized commercial real estate company (second in its segment by market value in Sweden) with good access to capital markets • Moderate tenant diversification with the top three accounting for 9.9% and the top 10 for 15.7% • Solid Scope-adjusted debt protection currently around of 2.6x and expected to remain above 2.2x going forward thanks to 70% hedging ratio, supported by positive operating cash flow • Property locations in large metropolitan areas and sought-after logistics hubs, strengthening liquidity	• Relatively high leverage with Scope-adjusted LTV of around 52% • High portfolio vacancy, somewhat mitigated by its stability • Short WAULT (slightly below average among Nordic peers) creating reletting risk • Profitability reduced to below 65% due to merger

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted LTV sustained around or below 50%	• Scope-adjusted LTV sustained above 60% or Scope-adjusted debt protection of below 2.2x

Corporate profile

Corem Property Group AB is one of the largest property companies in Sweden after its acquisition of Corem Kelly (previously known as Klövern AB) in an all-share merger in June 2021. Corem's portfolio is balanced between offices and logistics spaces, in addition to some retail exposure. The company owns and manages around 500 properties across Sweden, with some minor exposure to Denmark and the city of New York. Corem is headquartered in Stockholm and listed on Stockholm's large-cap stock exchange.

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.5x	2.6x	2.4x	2.3x
SaD/Scope-adjusted EBITDA	15.5x	27.9x	17.2x	16.1x
Scope-adjusted loan/value ratio	55%	52%	52%	52%
Scope-adjusted EBITDA in SEK m				
EBITDA	629	1,721	2,860	3,151
Operating lease payments	0	0	0	0
Other items	33	0	0	0
Scope-adjusted EBITDA	**662**	**1,721**	**2,860**	**3,151**
Funds from operations in SEK m				
Scope-adjusted EBITDA	662	1,721	2,860	3,151
less: (net) cash interest paid	-262	-638	-1,178	-1,327
less: cash tax paid per cash flow statement	-7	-3	-16	-16
add: dividends from associates	0	0	0	0
Other items	-12	-41	-10	0
Funds from operations	**465**	**1,149**	**1,664**	**1,817**
Free operating cash flow in SEK m				
Funds from operations	**465**	**1,149**	**1,664**	**1,817**
Change in working capital	-62	41	0	0
less: capital expenditure (net)	-228	-1,771	-1,622	-1,492
less: divestments	60	1,133	1,177	0
less: dividends pref shares	-72	0	-186	-248
Free operating cash flow	**163**	**552**	**1,033**	**77**
Net cash interest paid in SEK m				
Net cash interest per cash flow statement	262	638	1,178	1,327
add: interest component, operating leases	0	0	0	0
Add: interest component hybrids	0	20	38	38
Net cash interest paid	**262**	**658**	**1,216**	**1,365**
SaD in SEK m				
Reported gross financial debt	9,814	47,564	50,432	50,468
add: subordinated (hybrid) debt	0	631	631	631
less: cash and cash equivalents	15	571	2,221	769
add: derivatives	455	337	337	337
Other items	0	0	0	0
SaD	**10,254**	**47,961**	**49,178**	**50,667**

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Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	Grey leaf
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	Grey leaf
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend
Green leaf (ESG factor: credit-positive)
Red leaf (ESG factor: credit-negative)
Grey leaf (ESG factor: credit-neutral)

ESG profile

Corem follows the UN Global Sustainability Goals and has set targets to meet them: i) using only renewable energy by 2030; ii) climate neutrality throughout the value chain by 2035; iii) and a reduction of its energy consumption to a maximum of 65kWh/sq m 2030. Corem already uses 92% of renewable or climate-compensated (district heating) energy as of 2021. Increased resource efficiency in terms of renovation and recycling are top priorities, with the company using environmental certification systems (Swedish Green Building Council's Miljöbyggnad Silver/Gold level or a corresponding level of BREEAM and LEED) for every new construction or refurbishment. These efforts in the social and environmental realm enhance not only the attractiveness of its portfolio but also its profitability as the improvements increase the net rent ratio (rent excluding service charges) by maintaining gross rental levels.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB

Industry risk profile: BB

Corem's industry risk is modest. Corem has exposure to the highly cyclical commercial real estate industry (its main segments comprising the development, leasing and management of office and logistics buildings).

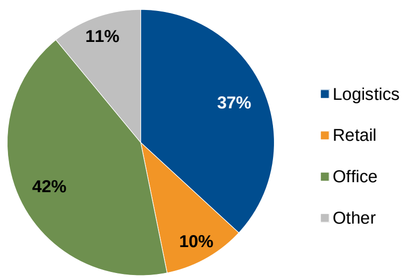
Medium-to-large commercial real estate with good access to external capital

Corem is a medium-to-large commercial real estate company based in Sweden with a core property value of SEK 83.9bn (EUR 8.0bn) and Scope-adjusted total assets of SEK 92.7bn (EUR 8.8bn) as of end March 2022.

The total lettable area of the company amounts to 3,411,000 sq m. In addition, the company owns unutilised building rights: 2,112,000 sq m (including 145,000 sq m at Tobin Properties) that it plans to start developing over the coming years. In late 2021 Corem initiated a joint venture management company with ALM Equity, which will develop and hold residential units. In February 2022 the parties entered into a binding agreement under which Corem intends to transfer properties worth SEK 5.4bn with a lettable area of 123,000 sq m to the joint venture in Q2 2022 and at a later stage building rights around Stockholm and Uppsala. Corem will own approximately 51% of the newly established joint venture.

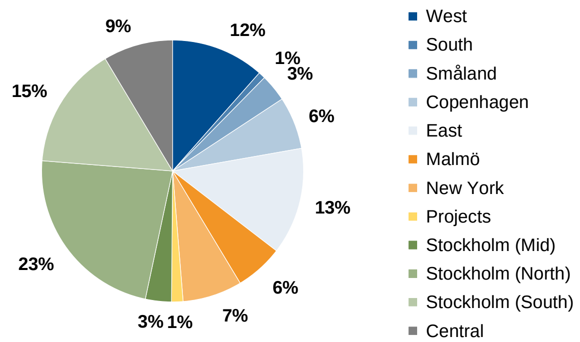
The company's size translates into decent diversification in terms of tenants and locations, which should enhance its resilience to cash flow volatility caused by economic cycles, industry developments, regulatory changes or the loss/default of single tenants. It also provides good access to capital markets, as shown by the regular issuance of class A, B and D shares, preference shares, secured and unsecured bonds in the Swedish markets, a SEK 5bn commercial paper programme (replacing Corem Kelly's SEK 4bn programme) and bank loans or private placements with Nordic banks in SEK, DKK and USD.

Figure 1: Asset type diversification by sq m



Sources: Corem Kelly, company accounts, Scope

Figure 2: Geographic diversification by Mvalue of assets



Sources: Corem Kelly, Scope

One of the largest Swedish commercial real estate companies

The acquisition of Klövern AB has increased Corem's visibility and reach to potential tenants and allowed a broader offering. It also brings the company more in line with the largest competitors. Its dominant position in most areas and the high market share in Stockholm has increased Corem's visibility to potential new tenants and allows it offer more opportunities to existing ones to suit their changing needs. High market shares increase tenant retention and yield a more stable occupancy in addition to reduced capex needs linked to tenant fluctuation.

Good geographical diversification, with a home country bias

Corem's geographical reach is good, with a strong foothold across Sweden (84% of assets by fair value) and two international exposures in Copenhagen (9%) and New York (7%). Most of Corem's performance thus hinges on macroeconomic developments in Sweden and Denmark, two mature and stable economies with a strong welfare/social system. This softens the impact of economic shocks, which in turn reduces rental losses.

More balanced portfolio after the acquisition

Before the merger Corem was strongly focussed on logistics, while Corem Kelly was predominantely active in office commercial real estate. By combining both portfolios, Corem is therefore less of a 'one-property-type-overweight' and has become a more balanced and more diversified company. In terms of rental space, Corem is balanced between logistics (37%) and office (42%), with some exposure to retail (10%) and other properties (10%). By market value the office segment accounts for 59%, logistics for 22%, retail for 6% and other exposures for 13%.

Moderate tenant diversification

Corem's tenant diversification is assessed as moderate, with the top three accounting for 9.9% and the top 10 for 15.7% of total rent. The top three concentration is due to Ericsson standing for 6.6% of total rent, somewhat mitigated by the spread-out exposure over 12 properties and 29 contracts and the perceived moderate-to-good credit quality. Corem's top 20 tenants are assessed as investment grade, seven of which are government agencies or companies (AA/AAA). Overall tenant quality based on credit losses is low investment grade. As a result, we consider the risk of a significant deterioration in cash flow due to a single tenant's default or delayed payments as marginal.

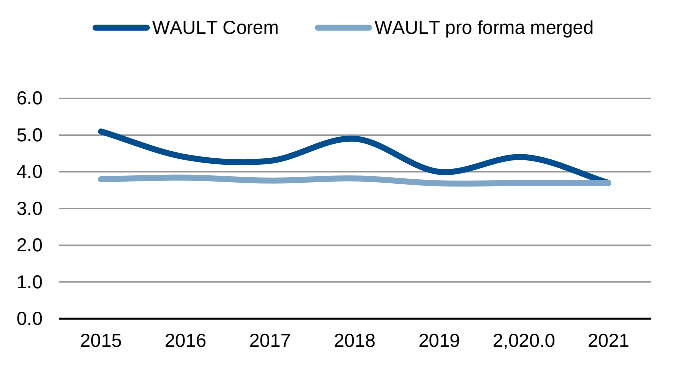
Asset quality benefits from 'A' locations

Corem's portfolio is concentrated around larger metropolitain cities (accounting for 68%) in Sweden and Denmark : Stockholm, Malmö, Copenhagen, Gothenburg and New York. Those locations are defined as 'A' locations from an investor's point of view, with several additional locations outside metropolitain cities on the logistics side being classified as 'A' locations from a tenant's perspective. The high share in large liquid markets is likely to result in good fungibility, meaning any haircuts to the portfolio would be limited should the company be in distress and have to sell assets. A scenario of financial distress is remote given Corem's financial risk profile.

Below-average occupancy

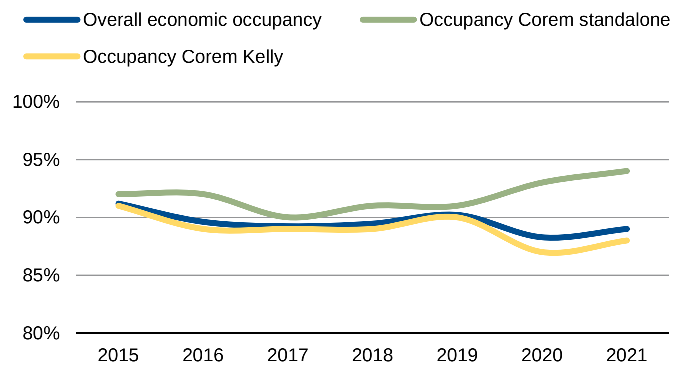
The company's economic occupancy rate has fluctuated around 90%, with Corem's standalone portfolio exceeding Corem Kelly's. 90% is relatively low for a traditional buy-and-hold company, especially for office space. Even so, we appreciate the reasoning behind the strategies and consider that the stability of vacancies across the cycle mitigates risks. Corem's management targets higher growth in occupancy and profitability in 2022, after 2021's focus was somewhat impacted by the integration of the two companies. The soft merger synergies have also given Corem deeper knowledge and networks in the segment of office and logistics space letting.

Figure 3: WAULT in years



Sources: Company name, Scope (estimates)

Figure 4: Economic occupancy rate



Sources: Company name, Scope (estimates)

Short WAULT

Corem's WAULT of 3.7 years as of end-March 2022 is short compared to European peers' and slightly below the Nordic peer average (four years). This is mitigated by the stability of WAULT within countercyclical movements in offices and logistics in the last five years.

Profitability dipped but expected to recover towards 65%

Corem's profitability was high among peers in 2017-2019, at around 76% as measured by the Scope-adjusted EBITDA margin (including dividends from long-term holding Klövern in revenue/EBITDA), reduced somewhat to around 70% during the recent streamlining in 2019. The merged profitability is diluted by Corem Kelly's lower margins and was impacted by acquitision-related one-off effects in 2021, coming in at a low 61.4%. Management is committed to reducing vacancies in 2022 in order to increase profitability and aims for less expansive growth. We foresee a significantly improving EBITDA this year with merger synergies on the cost side starting to materialise while one-offs fall out of the equation and foresees a recovery to an EBITDA margin of 65% over the next two years.

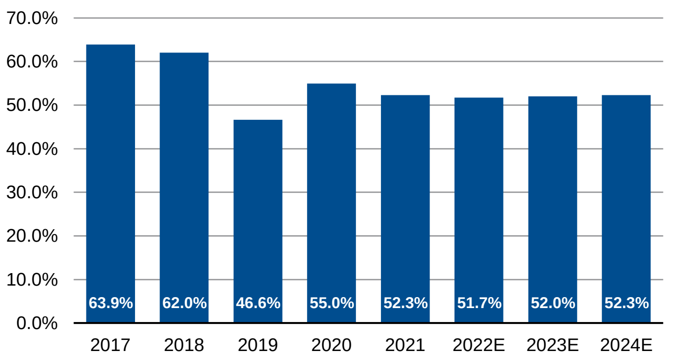
Financial risk profile: BB+

Leverage (LTV) at 52%

Corem's leverage as measured by LTV reduced significantly through streamlining and deleveraging in 2019, to 47% from around 60%. Two factors contributed to the stark deleveraging in 2019: i) a very strong year for Corem Kelly's share price, which was a holding at the time, resulting in a SEK 1bn increase in assets; and ii) the investment of cash left over after deleveraging into (short-term) holdings of listed real estate peers.

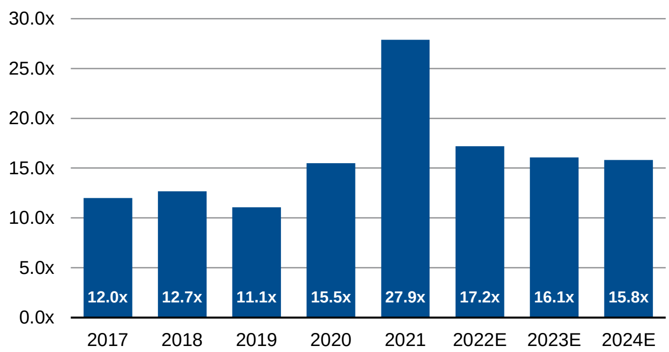
In 2020 deleveraging reversed, partly due to heavy investment into property development in addition to smaller acquisitions taking leverage as of YE 2020 up to 55%. Merging Corem and Corem Kelly resulted in a deleveraging path in our base case, thanks to an assumed deleveraging in both standalone companies' base cases. This has materialised in 2021, with LTV falling to 52% for the consolidated Corem Property group, mostly thanks to fair value gains. We expect a flat development around 52% going forward, in absence of any fair value appreciations. For Corem Kelly's portfolio this is conservative given that value-accreditive developments (e.g. in New York) might provide a value uplift.

Figure 5: Loan/value ratio (%)



Sources: Corem Kelly, Scope (estimates)

Figure 6: SaD/EBITDA ratio



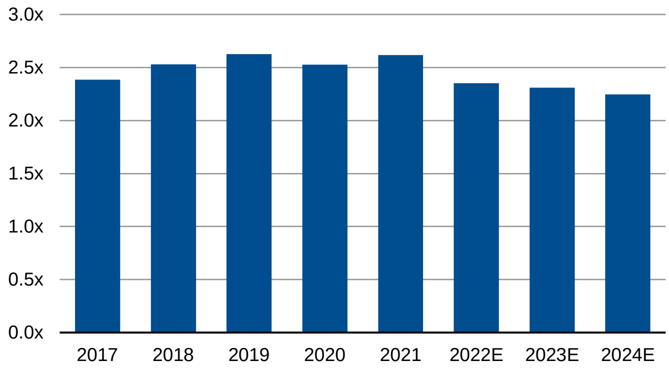
Sources: Corem Kelly, Scope (estimates)

Scope-adjusted debt-to-EBITDA has been stable at around 11x-13x historically. We expect the ratio to be around 15x-17x post-integration . As the company is predominantly active in buy-and-hold logistics and office properties, we do not apply any weight on this ratio.

Solid debt protection, expected to remain above 2.2x

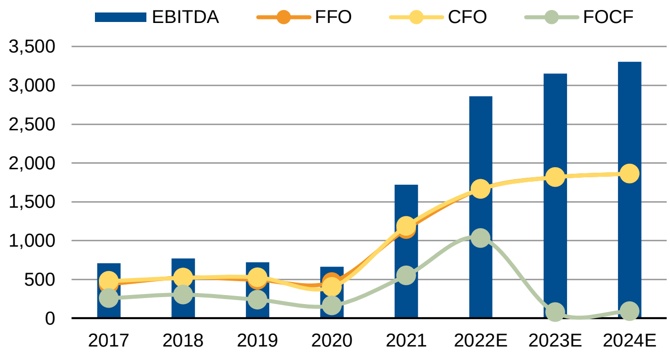
Corem's debt protection has been stable at around 2.5x. In line with the rest of the Nordic market, the company's preference for floating-rate debt helped by record-low interest rates and short financing terms have resulted in low cash interest payments. On a consolidated basis this resulted in a 2.6x interest cover in 2021. Our projections assume a continued low floating-rate profile for Corem. We highlight Corem's hedging efforts, currently at 68% of its floating exposure and management's intention to increase the ratio. This would mitigate base rate risks, benefit financing through the company's stronger standing in capital markets after the merger with Corem Kelly and the company's commitment to be investment grade. Assuming an increase in interest rates by 50bp from current levels for 2022E, and another 50bp in 2023 and 2024, interest coverage in absence of deleveraging weakens somewhat but remains above the 2.2x threshold at all times.

Figure 7: EBITDA/interest cover ratio (x)



Sources: Company name, Scope (estimates)

Figure 8: Cash flows



Sources: Company name, Scope (estimates)

Scope-adjusted FOCF (excluding discretionary capex) has been positive for the observed five years history. It is expected to remain positive also in 2022 due to some committed divestment. In 2023 and 2024 we anticipate significant maintenance/mandatory capex in line with 2022, which in absence of divestments takes FOCF down to break-even levels but remaining slightly positive.

Adequate liquidity

Corem, like most Nordic peers, has relied on relatively short-term funding. Excess liquidity has been invested in marketable securities, namely listed equities of Swedish real estate peers. The company uses revolving cash facilities/check credit facilities or the sale of marketable securities for short-term funding needs and uses secured bank debt or unsecured bonds for its long-term needs.

At FY 2021 Corem's secured LTV was 38%, giving the company the possibility to increase debt on existing properties within the company's framework of up to 70% LTV on bank loans, in case the short-term market would not allow them to refinance.

Corem's next unsecured maturity (apart from commercial papers) is a SEK 484m unsecured bond in February 2023. In the unlikely scenario where the company would not manage to refinance its bond, the undrawn facilities currently worth SEK 5.4bn could cover it fully.

The likelihood of banks not refinancing secured loans pledged in real estate with LTVs below the banks' requirements is low. The company enjoys good relationships with all larger Nordic banks and has tied them closely through loans with various maturities.

Given the above, liquidity is judged adequate.

Balance in SEK m	2022E	2023E
Unrestricted cash (t-1)	571	2,221
Open committed credit lines (t-1)	4,719	5,416
Free operating cash flow	1,033	77
Short-term debt (t-1)	14,548	13,964
Coverage	**58%**	**71%**

Appendix: Peer comparison (as at last reporting date)

	Corem Property Group	Corem Kelly	Norwegian Property ASA	Fastpartner	Globe Trade Centre S.A.
	BBB-/Stable	BBB-/Stable	BBB-/Stable	BBB-/Stable	BBB-/Stable/--
As of reporting date	31 March 2022	31 March 2022	31 Mar 2022	30 Jun 2021	30 Sep 2021
Business risk profile					
Scope-adjusted total assets (EUR m)	9,005	6,906	2,806	3,450	2,596
Portfolio yield	5.1%	5.1%	3.7%	4.6%	6.9%
Gross lettable area (‘000s sq m)	3,411	2,477	505	1,517	
No. of residential units	na	na	n/a	n/a	854
					n/a
No. of countries active in	3	3	1	1	
Top three tenants (%)	9.9%	12.3%	32%	9.5%	6
Top 10 tenants (%)	15.7%	19.7%	48%	19.5%	9%
Office (share NRI)	53%	73%	67%	47%	22%
Retail (share NRI)	10%	13%	8%	13%	70%
Residential (share NRI)	na	0%	0%	1%	30%
Hotel (share NRI)	na	3%	0%	6%	n/a
Logistics (share NRI)	23%	11%	6%	15%	n/a
Others (share NRI)	11%	0%	19%	18%	n/a
					n/a
Property location	‘A’ and 'B'	‘A’ and ‘B’	'A'	‘A’	'B'
EPRA occupancy rate (%)	89%	88%	93%	91%	91%
WAULT (years)	3.7	3.5	5.1	4.7	3.4
Tenant sales growth (%)	na	na	n/a	n/a	n/a
Like-for-like rent growth (%)	na	na	n/a	n/a	n/a
Occupancy cost ratio (%)	na	na	n/a	n/a	n/a
Scope-adjusted EBITDA margin[2]	62%	60%	81%	69%	85%
EPRA cost ratio (incl. vacancy)	na	na	n/a	n/a	n/a
EPRA cost ratio (excl. vacancy)	na	na	n/a	n/a	n/a
Financial risk profile					
Scope-adjusted EBITDA interest cover (x)[8]	2.6x	2.5x	2.3x	4.1x	3.4x
Loan/value ratio (%)	55%	51%	44%	45%	54%
SaD/Scope-adjusted EBITDA (x)[8]	21.3x	19.5x	15.8x	12.8x	13.5x
Weighted average cost of debt (%)	2.7%	2.1%	2.8%	1.70%	2.1%
Unencumbered asset ratio (%)	na	na	n/a	220%	155%
Weighted average maturity (years)	3.8	4.1	4.2	3.3	5.0

*Subscription ratings available on ScopeOne

Sources: Public information, Scope

[2] Includes all GLA surfaces, above and below ground

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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