Norwegian Property ASA
Norway, Real Estate

SCOPE BBB- STABLE

Corporate profile

Norwegian Property ASA (NPRO) is a commercial real estate company headquartered in Oslo with direct activities in Norway and exposure to Sweden through a joint venture. Its core business involves the acquisition, sale, development and management of high-quality office buildings in prime locations. The company mostly focuses on managing its properties and limits development to refurbishing. In addition, the company owns a 42.4% joint venture share in NORDR, a residential real estate developer active in Norway and Sweden. NPRO was founded in 2006, and it owned NOK 27.4bn of assets as at Q1 2022.

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.1x	2.2x	2.4x	2.3x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	20.9x	15.9x	15.7x	15.5x
Scope-adjusted loan/value ratio	47%	44%	46%	48%

Rating rationale

Scope assigns first-time issuer rating of BBB-/Stable to Norwegian Property ASA

NPRO's business risk profile benefits from strong asset quality characterised by a high share of office space in sought-after grade A locations in greater Oslo. Its asset quality is strengthened by the young economic age of its property portfolio, a 93% occupancy rate and an above-average weighted unexpired lease term (WAULT) of 5.1 years. High profitability, with a Scope-adjusted EBITDA margin of between 75% and 80% (LTM Q1 2022: 81%), and low volatility further benefit the rating. The rating is constrained by limited geographic diversification and high tenant concentration, which was adversely affected by the acquisition of Telenor's headquarters building. The latter is partially mitigated by an implied investment-grade tenant base based on historical bad-debt statistics and broad tenant industry diversification.

NPRO's financial risk profile benefits from stable debt protection of around 2.3x as measured by Scope-adjusted EBITDA interest coverage, which we expect to continue. Free operating cash flow has remained positive (excluding discretionary acquisition capex) and is expected to benefit greatly beyond our rating case horizon thanks to dividends from the minority stake (42.4%) in JV NORDR (a residential real estate developer). NPRO has managed to keep its Scope-adjusted loan/value (LTV) ratio below 50% since 2016 despite significant transactions in 2020, such as the investment in the NORDR joint venture and the acquisition of the Telenor portfolio in Fornebu.

NPRO's leverage, as measured by its LTV ratio, fell below 50% in 2016 and has remained there ever since (Q1 2022: 44%). This is despite significant transactions in 2020, mitigated through partly equity financing those. Our base case expects the company's LTV ratio to remain between 45% and 50% going forward despite a continuation of business as usual with acquisitions (expected at NOK 1.5bn per annum).

We have assessed liquidity as adequate even though ratios have historically remained below 1x and are expected to remain at that level in future. However, we believe liquidity to be a manageable risk thanks to: i) all outstanding debt being secured in properties; ii) proven access to capital and bank markets and a willingness to raise equity if needed; and iii) a spread-out maturity profile and the company's financial policy.

Ratings & Outlook

Corporate rating BBB-/Stable

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Related Methodologies

Corporate Rating Methodology: July 2021

Rating Methodology: European Real Estate Corporates January 2022

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Bloomberg: RESP SCOP

Outlook and rating-change drivers

The Outlook for NPRO is Stable and incorporates a continuation of inorganic growth through acquisitions within its core markets in central Oslo, financed with a mix of debt and internal cash flow. Our rating case includes acquisitions worth NOK 1.5bn per annum for 2022 and 2023 and no disposals of properties. This results in a LTV ratio of between 45% and 50% and Scope-adjusted EBITDA interest cover of around 2.3x.

A negative rating action could occur if the LTV ratio climbed towards 55% or Scope-adjusted EBITDA interest cover fell below 2.0x on a sustained basis. This could be caused by a severe reduction in the fair value of properties compared to our base case, a large drop in achievable rents due to new regulations, drastically different demand patterns, or an unexpectedly severe impact from the pandemic. The LTV ratio could also increase due to a large debt-financed acquisition.

A positive rating action would require a LTV ratio below 40% and significant growth in assets leading to better diversification of cash flow. The LTV trigger could be driven by a lower proportion of debt-funded capex, decreased refinancing needs through stronger-than-anticipated portfolio cash flow, a substantial improvement in market sentiment resulting in high fair value appreciation, or a change in the funding mix. Cash flow diversification could be driven by renting out the part of the Telenor property that is currently vacant but guaranteed or by broadening geographies and tenants.

Rating drivers

Positive rating drivers	Negative rating drivers
• Norwegian Tier 1/European Tier 2 commercial real estate company with comparatively high market shares in its core markets • Grade-A office stock, young economic age and prime locations positively influence strength and stability of operating cash flow throughout the cycle • Stable and peer-group leading profitability with EBITDA margins around 80% • Stable EBITDA interest cover, helped by relatively high hedging ratio	• Dominant exposure to one market, partially mitigated by economic strength and low cyclicality in Oslo • Modest tenant diversification with top three and top 10 accounting for 32% and 48% of rental income, driven and partially mitigated by good credit quality of largest tenant Telenor, as well as good tenant quality of the remainder and tenant industry diversification

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• LTV ratio significantly below 40% on a sustained basis and growth in size leading to better diversification of cash flow	• LTV ratio rising towards 55% or Scope-adjusted EBITDA interest cover below 2.0x both on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.1x	2.2x	2.4x	2.3x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	20.9x	15.9x	15.7x	15.5x
Scope-adjusted loan/value ratio	47%	44%	46%	48%
Scope-adjusted EBITDA in NOK m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	613	736	856	952
Operating lease payments in respective year	0	0	0	0
Other	-56	0	0	0
Scope-adjusted EBITDA	557	736	856	952
Scope-adjusted funds from operations in NOK m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	557	736	856	952
less: (net) cash interest as per cash flow statement	-261	-331	-359	-412
less: cash tax paid as per cash flow statement	0	0	0	0
add: income received from associated companies	2	0	0	100
Scope-adjusted funds from operations	298	405	497	640
Scope-adjusted debt in NOK m	**2020**	**2021**	**2022E**	**2023E**
Reported gross financial debt	12,097	12,005	13,583	15,033
less: cash and cash equivalents	-666	-314	-183	-326
add: cash not accessible	0	0	0	0
add: derivatives	203	44	44	44
add: operating lease obligations	0	0	0	0
Other	0	0	0	0
Scope-adjusted debt	11,634	11,735	13,444	14,751

Business risk profile: BBB-

Industry risk: BB

NPRO's core business is the management of its commercial real estate portfolio with a property value of NOK 25.8bn as of Q1 2022. In 2020, the company teamed up with Fredensborg and Union Real Estate Fond to acquire Veidekke Eiendom (renamed NORDR), focussing on the development of residential real estate. Its 42.4% share stake in the joint venture is dwarfed by the remainder of its property portfolio. Given that the joint venture is not expected to generate any cash inflow for NPRO until 2023 at the earliest, we have not taken it into consideration in the industry risk profile.

Medium-sized commercial real estate corporate

NPRO is a medium-sized, publicly listed real estate corporate based in Norway with a core property value of NOK 25.8bn (EUR 2.6bn) and NOK 27.3bn (EUR 2.8bn) of Scope-adjusted total assets as of end-March 2022. The company's gross leasable area is 505,000 sq m. The company commands a dominant market share within its niche areas of Aker Brygge, a part of Oslo's CBD, Nydalen and Fornebu, but it only holds an estimated 6% of office space in the wider Oslo market.

Given the highly fragmented nature of the market, in which the largest listed player Entra holds around 7% of Oslo office space, NPRO's size and concentration on Oslo CBD leads to a relatively high market share (assessed around 6%) and high visibility for tenants and investors in Oslo. It also provides good access to capital markets, demonstrated by the regular issuance of secured bonds in NOK and its capital raises during the pandemic. The acquisition of all remaining outstanding shares by Geveran Trading Co. Ltd. in July 2021 and the subsequent delisting from the stock exchange are seen as neutral to NPRO's capital market standing because: i) the company continues to actively use the bond market and maintains the same reporting routines and commitment to financial policy, mitigating a potential risk of increased extraordinary dividends, and ii) even before the delisting, the major shareholder was dominant and therefore the main source of equity injections, which we foresee to continue as needed. We understand that NPRO aims to grow its asset portfolio in its core market of Oslo further.

Geographical diversification weak, mitigated by asset quality

NPRO's portfolio is solely based in Norway, and its direct ownership is only in greater Oslo as the company offloaded its Stavanger portfolio into a joint venture (50% ownership). Therefore, we assess the company's geographical diversification as weak, mitigated by a healthy macroeconomic outlook; asset quality in sought-after areas; and a diverse tenant mix in its core market of Aker Brygge/Nydalen that has demonstrated resilience during the recent pandemic. Furthermore, we view NPRO's focus on centrally located 'value-add' office space – a mix of ground-floor retail/restaurants and underground parking facilities to make the space attractive and more liveable – as a mitigating factor to its modest diversification across property segments.

The acquisition of 40.6% (increased to 42.4% as of writing) of NORDR Eiendom in 2020 via a joint venture will enhance NRPO's geographical reach once material cash flows are paid out to NPRO, as NORDR develops residential real estate across Sweden and Norway with a focus on the capitals and larger cities.

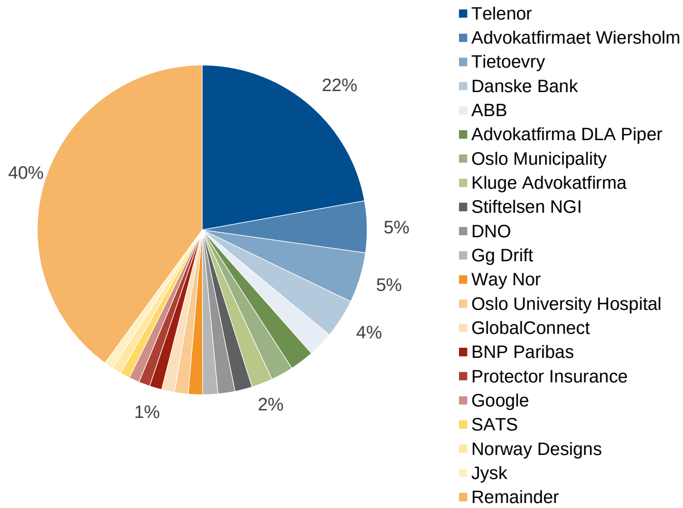
Modest tenant diversification mitigated by good tenant quality

NPRO gained a significant new tenant thanks to its acquisition of Telenor's headquarters building (Norway's largest telecom company, majority-owned by the state). Telenor alone now accounts for 16% of rental income. The company guarantees the rent for the portion of the building that is currently vacant and undergoing refurbishment, resulting in a total share of 22%. The concentration risk of the largest tenant Telenor is somewhat mitigated by its strong credit quality (high investment-grade) characteristics and the Norwegian state's majority ownership of the company. In addition, low reletting risk is a mitigant as Telenor has a remaining 24-year rental agreement for its headquarters (15% of the property's rental run-rate) and guarantees the rent for currently vacant spaces for the next seven years, bringing the WAULT of this property to 8 years.

The next largest tenant after Telenor is Wiersholm Lawyers with 5.1%, followed by Evry (IT) with 4.9%, bringing top three tenant concentration to 32%. Top 10 tenant concentration is naturally concentrated too, at 48%.

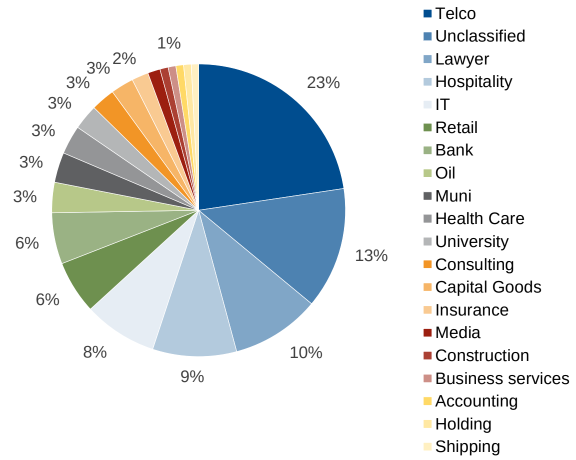
The company's multi-tenant strategy for all its properties should broaden tenant diversity and reduce lumpy renewal risk at contract maturity for single-tenant buildings, which is positive from a cash flow visibility point of view. NPRO's total implied tenant quality, based on the percentage of bad debt during the last five years, is assessed as investment-grade.

Figure 1: Tenant diversification by NRI[1]



Sources: NPRO, Scope

Figure 2: Tenant industry diversification by NRI



Sources: NPRO, Scope

Good tenant industry diversification

The company's aim is to own attractive office properties, with retail/restaurant facilities and underground parking facilities attached. This can be observed from its property diversification, comprising 67% offices, 17% indoor parking, 8% retail/restaurants and 6% warehouse space (measured in sq m; normally all categories within one building). This results in very diverse tenants who operate in a variety of industries exposed to different degrees of cyclicality and business cycles. The top five segments are telecom (16% Telenor; including guaranteed rent: 22%), lawyers (10%), IT services (8%), hospitality (6%), banks (6%) and retail (3%), facing different business cycle patterns. The remainder is split across a variety of industries, all only making up a small single-digit percentage share. Governmental tenants make up around 7% of rental income.

NPRO's portfolio consists of mainly modern (or refurbished), energy-efficient (mostly class A), inner-city locations in A location-ranked Oslo. 67% of its properties (measured by rental income) are in prime locations in Aker Brygge (the CBD) or in Nydalen, with the remainder in Fornebu, a hub for the oil and gas industry and telecoms. Through its joint venture, the company is exposed on the office side to a small portfolio in Stavanger and on the residential side to developments predominantly in the Oslo and Stockholm areas.

Young economic age of portfolio

The economic age of the CBD locations (51% of portfolio by rental income) is 4.5 years. The Nydalen portfolio is a mix of newly refurbished properties and some from the 1990s (part-refurbished since) and therefore comes in at a dated 14 years, while the Snarøyveien 36 and Snarøyveien 30 buildings are currently undergoing partial refurbishments and are therefore 'very young' in this context. Overall, we assess the portfolio's economic age at 3.7 years, demonstrating the company's ongoing focus on refurbishment, which keeps it attractive for tenants and potential investors alike.

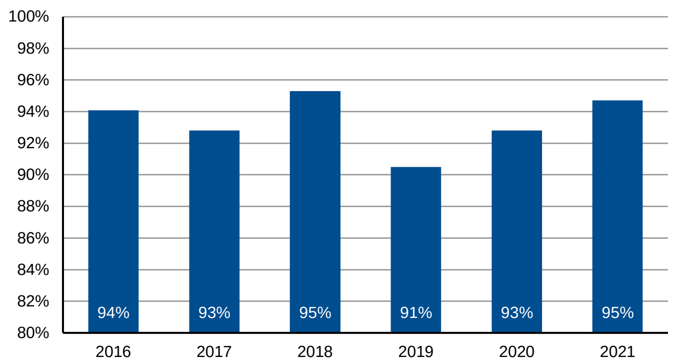
[1] NRI = net rental income

Economic vacancy of 6.8%

At Q1 2022, NPRO's overall economic vacancy stands at 6.8%, down from 8.0% YoY. The rate has been fluctuating between 4.7% and 9.5% for the last five years, with changing culprits driving it. At present, the property at Snarøyveien 36 in Fornebu is one of the drivers behind the higher vacancy level, as a large tenant moved out in 2019 and the company has refurbished the property since then. Looking at the historical trend, WAULT has been decreasing. This is to a certain degree explainable through the cluster of long-term leases in the CBD that were all signed after the refurbishment and ticked down every quarter from their initial lease of mostly 10 years. The company has managed to reverse the trend in 2019 and showed a stark increase in 2020 thanks to the acquisition of Snarøyveien 30, lifting WAULT to 5.9 years at YE 2020. This is thanks to Telenor signing a 25-year lease for their headquarters and guaranteeing the rent for the unlet spaces for eight years at acquisition in autumn 2020. NPRO's overall WAULT currently stands at 5.1 years and compares favourably to an average Nordic WAULT of four years, although we note that its exposures in Aker Brygge (4.1 years) and Nydalen (3.3 years) are in line with peers.

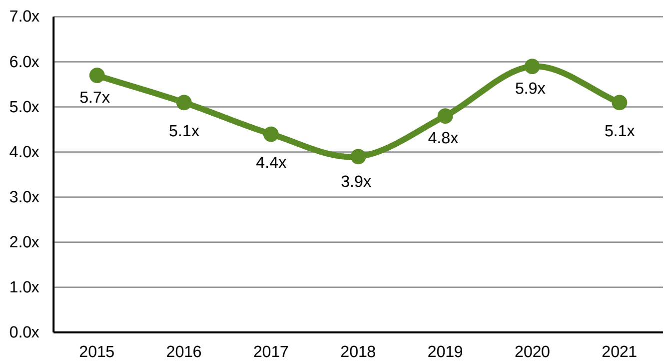
WAULT of 5.1 years compares favourably to Nordic peers

Figure 3: Economic occupancy



Sources: NPRO, Scope

Figure 4: WAULT (years)

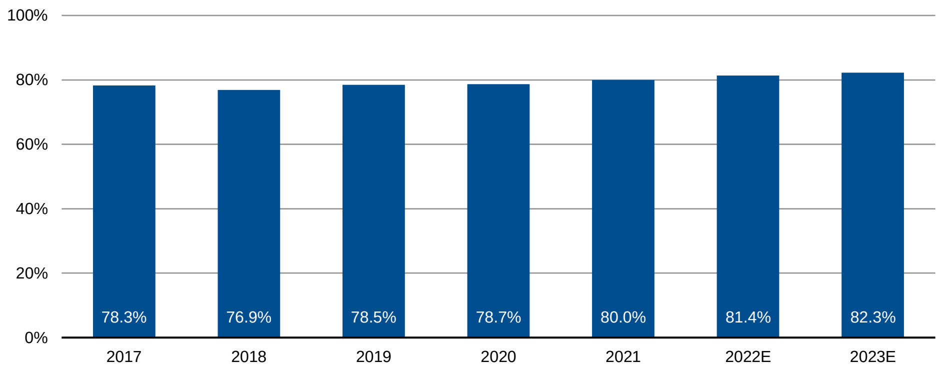


Sources: NPRO, Scope

High profitability at around 80%

NPRO's profitability, as measured by its Scope-adjusted core property EBITDA margin, stood at 81% for LTM Q1 2022. Its profitability has been above average and fairly stable for the last six years at between 75% and 80%, driven by good cost control and economies of scale in its geographically concentrated property portfolios, allowing for the in-housing of most management functions and increasing tenant satisfaction. We believe that profitability from property management will continue to be stable and high, at around 81% according to our estimates, with similarly yielding prime properties (compared to the current portfolio) in our acquisition estimates. Management's focus on vacancies, a lean cost structure and a young portfolio provide comfort with regard to NPRO's margin.

Figure 5: Profitability (Scope-adjusted EBITDA margin)



Sources: NPRO, Scope estimates

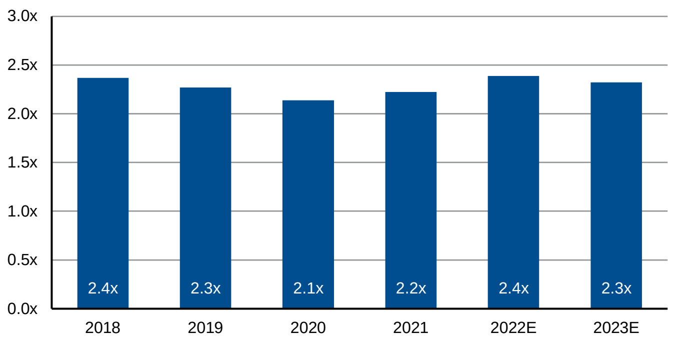
Financial risk profile: BBB-

Stable debt protection supported by operating cash flows

NPRO's debt protection as measured by Scope-adjusted EBITDA interest cover has been above 2.1x since 2017, thanks to: i) deleveraging in 2015-2016 that brought down absolute debt levels; and ii) the current low interest environment (despite paying high premiums for their hedging activities). We expect coverage to remain at around 2.3x going forward by growing EBITDA organically and inorganically while keeping interest rate levels under control even in an increasing interest rate environment, thanks to significant hedging activities of 70% and 64% for 2022-2023 and a remaining maturity time of interest rate hedges of 6.5 years.

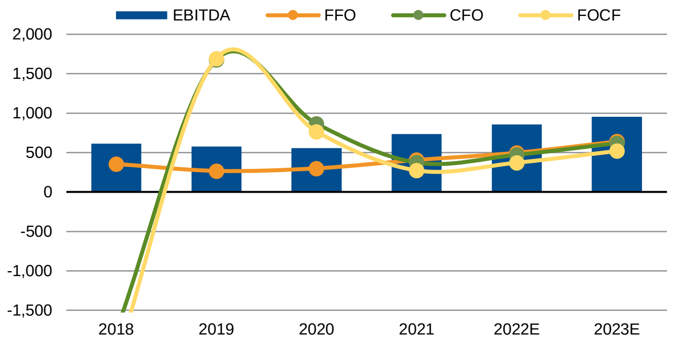
The company's financial policy to hedge 50%-100% of all floating rate debt at all times gives us comfort in our assessment, while its covenant of a 1.4x interest cover ratio is not restrictive enough to benefit the assessment.

Figure 6: Scope-adjusted EBITDA/interest cover (x)



Sources: NPRO, Scope estimates

Figure 7: Cash flows in NOK m



Sources: NPRO, Scope estimates

Positive cash flows despite expansion

NPRO's funds from operations shows stability over the observed history and is expected to grow in tandem with EBITDA going forward, supported by the company's stable rental cash flow. Its cash from operations and free operating cash flow metrics have been impacted in recent history by the acquisition of the Hasle project, which resulted in extraordinary working capital swings related to the residential development activities that came alongside the commercial real estate part of the property. With the completion and final sale of the remaining flats in 2020, NPRO's free operating cash flow is forecasted at more normalised levels going forward and remains positive, covering all mandatory capex. While forecasted dividends are covered with good headroom by operating cash flows, potential acquisition capex renders discretionary cash flows negative as we assume those to be fully debt-funded.

Beyond the horizon of our rating case, in 2024 and thereafter, NPRO expects the first cash distribution from its 42.4% share stake in the NORDR joint venture to contribute significantly to cash flow (budgeted to start with around NOK 100m for 2023).

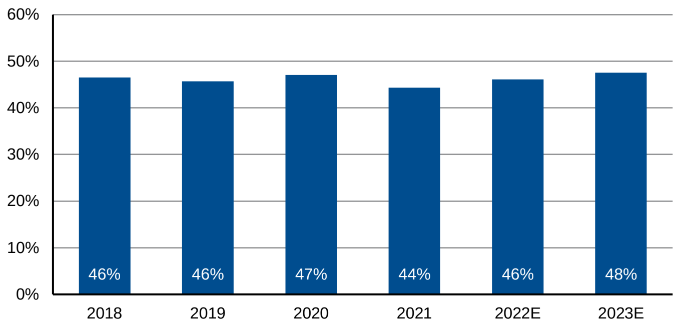
Stable LTV between 45% and 50% despite significant transactions

Leverage measured by LTV ratio has come down significantly in 2016. NPRO's measures to improve its financial metrics (e.g. scrapped dividends, repayment of debt after asset sales) and valuation uplifts brought down interest-bearing debt to NOK 6.8bn as at YE 2016 from NOK 9.6bn as at YE 2015 and the Scope-adjusted LTV ratio to below 50%, where it has remained ever since. Despite significant transactions in 2020 with the investment in the NORDR joint venture and the acquisition of the Telenor portfolio in Fornebu, the company has managed to keep its LTV ratio stable by issuing NOK 1.7bn in new equity.

The company's leverage has been around 44%-47% for the last three years, and our base case expects it to stabilise at current levels of 45%-50% for the foreseeable future based on: i) the company's target of an LTV ratio of 45%-55% through the cycle; ii) a continuation of business as usual with acquisitions (expected at NOK 1.5bn per annum for 2022 and 2023) and positive like-for-like growth; and iii) more muted fair value appreciation in our projections balancing debt funded growth.

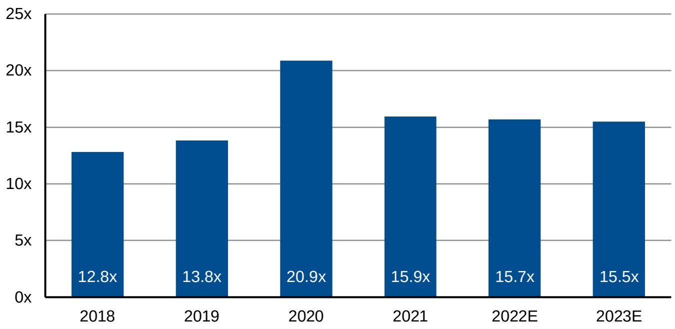
The SaD/Scope-adjusted EBITDA ratio was around 13x-14x before the large acquisitions in 2020 and is expected to stabilise at around 16x going forward. While elevated, its impact on our financial risk assessment remains limited due to the prime characteristics of the buy-and-hold commercial real estate portfolio where some uncertainty in the medium term is balanced out by sought-after central locations. The potential future recognition of joint venture cash flows under EBITDA given its recurring characteristics and/or the potential deleveraging effects of those flows support our view.

Figure 8: Leverage (Scope-adjusted loan/value ratio)



Sources: NPRO, Scope estimates

Figure 9: Leverage (SaD/Scope-adjusted EBITDA)



Sources: NPRO, Scope estimates

Adequate liquidity

NPRO's internal liquidity cover was and is expected to be below par as the company keeps relatively limited cash on its balance sheet, and its revolving RCFs are mostly one year rolling. It has one three-year RCF with Nordea/SEB/DNB for NOK 1bn (currently undrawn, matures in September 2022), with the remainder of RCFs totaling NOK 800m (all undrawn) up for annual renewal. Short-term debt coverage by internal and external sources remains below 1x most years. However, we believe liquidity to be a manageable risk thanks to: i) all outstanding debt being secured in properties with a current average LTV ratio of 44% and a maximum LTV ratio allowance of 65%-75% providing ample headroom; ii) the company's proven access to capital and bank markets through frequent issuances of debt instruments and a willingness to raise equity if needed; and iii) a spread-out maturity profile and the company's financial policy of not allowing maturing debt of more than 20% of total loans over the next 12 months to be rolling. While the secured nature of NPRO's debt eases refinancing, the encumbrance of the whole portfolio limits the company's flexibility to approach capital market debt (especially senior unsecured debt).

Figure 10: Liquidity

NPRO (NOK m)	2022E	2023E
Short-term debt (t-1)	2,422	400
Unrestricted cash (t-1)	314	183
Open committed credit lines (t-1)	0	0
Free operating cash flow (t)[2]	371	519
Coverage	**0.3x**	**1.8x**

Sourcse: NPRO, Scope estimates

[2] We exclude discretionary expansion capex from the liquidity calculation, as such investments are made only if external financing is available.

Appendix I: Peer comparison

	Norwegian Property ASA	Fastpartner	Globe Trade Centre S.A.	Inmobilaria Colonial SOCIMI S.A. **	Merlin Properties SOCIMI S.A.
	BBB-/Stable	BBB-/Stable	BBB-/Stable/--	--/--*	--/--*
As of reporting date	2022-03-31	2021-06-30	2021-09-30	2021-12-31	2021-12-31
Business risk profile					
Scope-adjusted total assets (EUR m)	2,806	3,450	2,596	12,117	13,406
Portfolio yield	3.7%	4.6%	6.9%	2.8%	3.8%
Gross lettable area (thousand sq metres)	505	1,517	854	1,678	3,385
No. of residential units	na	na	na	na	na
No. of countries active in	1	1	6	2	2
Top three tenants (%)	32%	9.5%	9%	10%	9%
Top 10 tenants (%)	48%	19.5%	22%	26%	19%
Office (share NRI)	67%	47%	70%	94%	63%
Retail (share NRI)	8%	13%	30%	5%	22%
Residential (share NRI)	0%	1%	na	100%	0%
Hotel (share NRI)	0%	6%	na		0%
Logistics (share NRI)	6%	15%	na	0%	13%
Others (share NRI)	19%	18%	na	1%	2%
Property location	'A'	‘A’	'B'	A	A
EPRA occupancy rate (%)	93%	91%	91%	96%	95%
WAULT (years)	5.1	4.7	3.4	4.2	5.4
Tenant sales growth (%)	na	na	na	na	na
Like-for-like rent growth (%)	na	na	na	2.0%	0.4%
Occupancy cost ratio (%)	na	na	na	na	
Scope-adjusted EBITDA margin[3]	81%	69%	85%	79%	77%
EPRA cost ratio (incl. vacancy)	na	N/A	na	20.7%	20.5%
EPRA cost ratio (excl. vacancy)	na	N/A	na	18.8%	18%
Financial risk profile					
Scope-adjusted EBITDA interest cover (x)[8]	2.3x	4.1x	3.4x	2.3x	3.1x
LTV (%)	44%	45%	54%	37.7%	40.3%
Scope-adjusted debt/Scope-adjusted EBITDA (x)[8]	15.8x	12.8x	13.5x	19.4x	14.8x
Weighted average cost of debt (%)	2.8%	1.70%	2.1%	1.4%	2.1%
Unencumbered asset ratio (%)	na	220%	155%	235%	204%
Weighted average maturity (years)	4.2	3.3	5.0	5.2	5.3

*Scope subscription ratings available on ScopeOne

[3] includes all GLA surfaces, above and below ground

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