15 July 2021 | Corporates

Corem Property Group AB Sweden, Real Estate

SCOPE BBB- STABLE

Corporate profile

Corem Property Group AB is one of the largest property companies in Sweden after its acquisition of 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 US city of New York. Corem is headquartered in Stockholm and listed on Stockholm's mid-cap stock exchange.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	2.6x	2.5x	2.5x	2.8x
Scope-adjusted debt (SaD)/EBITDA	11.1x	15.5x	17.3x	16.3x
Scope-adjusted loan/value ratio (%)	47%	55%	56%	55%

Rating rationale

Scope assigns a first-time rating of BBB-/Stable to Corem Property Group AB

The rating is driven by the company's business risk profile (assessed at BBB), supported by the recent acquisition of Klövern AB, which lifted market shares in logistics and added an office portfolio with moderate market shares across Swedish metropolitan areas. The rating also benefits from a moderate geographical outreach, a diversified and balanced portfolio within commercial real estate (CRE) asset classes, and moderate tenant concentration of moderate tenant credit quality (low investment grade). The financial risk profile benefits from a forecasted increase of Scope-adjusted EBITDA interest cover as well as the focus on reducing vacancy over previous growth strategies, which helps with deleveraging in terms of the Scope-adjusted loan/value (LTV) ratio.

The rating is constrained by comparatively low profitability (Scope-adjusted EBITDA margin), a below-average weighted average unexpired lease term, and a relatively high overall vacancy. The high LTV also constrains the rating.

Outlook and rating-change drivers

The Outlook is Stable and incorporates Klövern's successful integration, a modest growth strategy going forward, and an increased focus on reducing vacancies in the combined portfolio. It further incorporates our expectation of a slow decrease in LTV while Scope-adjusted EBITDA interest cover remains above 2.2x. We also expect continued positive cash flow, as measured by Scope-adjusted free operating cash flow, as well as positive discretionary cash flow once the development programme is complete.

A negative rating action is possible if LTV reaches above 60% on a sustained basis or Scope-adjusted EBITDA interest cover weakens below 2.2x. This could be driven by an increase in interest-bearing debt through heavily debt-financed acquisitions, or remortgaging amid worsening economic or market sentiment that puts real estate asset

Ratings & Outlook

Corporate ratings BBB-/Stable

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Related Methodologies

Corporate Rating Methodology: July 2021

Rating Methodology: European Real Estate Corporates January 2021

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values under pressure and/or significantly reduces income while interest costs are elevated.

A positive rating action could be warranted if LTV reaches around 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 drivers

Positive rating drivers	Negative rating drivers
• Medium-sized CRE company (second by CRE market value in Sweden) with good access to capital markets • Moderate tenant diversification with top three accounting for 9% and top 10 for 15% • Solid Scope-adjusted debt protection of currently around 2.5x and increasing, supported by positive operating cash flows • Property locations in large metropolitan areas and sought-after logistics hubs, strengthening liquidity	• High leverage for the rating with Scope-adjusted LTV of around 55%, mitigated by deleveraging path • High portfolio vacancy, somewhat mitigated by its stability • Short WAULT (slightly below average among Nordic peers) creating reletting risk • Profitability reduced to around 65% due to merger

Rating-change drivers

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

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	2.6x	2.5x	2.5x	2.8x
Scope-adjusted debt (SaD)/EBITDA	11.1x	15.5x	17.3x	16.3x
Scope-adjusted loan/value ratio (%)	47%	55%	56%	55%
Scope-adjusted EBITDA in SEK m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	661	629	2,673	2,823
Operating lease payments in respective year	0	0	0	0
Dividends from long-term holding Klövern	61	33	0	0
Scope-adjusted EBITDA	722	662	2,673	2,823
Scope-adjusted funds from operations in SEK m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	722	662	2,673	2,823
less: (net) cash interest as per cash flow statement	-275	-262	-1,082	-1,027
less: cash tax paid as per cash flow statement	-7	-7	-51	-51
add: dividends received from shareholdings	64	84	61	64
Other	-11	-12	0	0
Scope-adjusted funds from operations	493	465	1,601	1,810
Scope-adjusted debt in SEK m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	7,564	9,814	45,508	45,845
add: hybrid bonds	0	0	631	631
less: cash and cash equivalents	-8	-15	-524	-1,027
add: cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other	424	455	541	541
Scope-adjusted debt	7,980	10,254	46,155	45,990

Business risk profile: BBB

Successful acquisition of Klövern AB

Corem's offer to acquire all outstanding ordinary shares in Klövern AB (class A, class B and preference shares) in exchange for newly issued shares in Corem was accepted by 95% of shareholders at the time of writing, surpassing Corem's 90% target. Approvals have been granted by competition authorities and at Corem's annual general meeting. Klövern AB is being delisted from the stock market on 19 July 2021. Integration with Corem is ongoing, and management will eventually consist of employees from both companies.

Industry risk: BB

Corem's industry risk is modest, with an exposure to the highly cyclical CRE industry. Its main segments comprise the development, leasing and management of logistics, office and retail properties.

Credit outlook stable for European real estate in 2021

The 2021 credit outlook for European real estate remains stable despite the Covid-19 effects on the European economy. Weak spots are still the retail sector, the general UK market and second-tier properties, while demand continues to be strong for some industrial property types, namely logistics and data centres.

For the residential sub-segment, we expect i) stable rates for rental growth, occupancy, and yields, ensuring steady leverage ratios; ii) a continued rise in prices; and iii) more focus on diversification as regulatory pressure – from rent controls to greenhouse-gas targets – intensifies. For the office sub-segment, we expect i) stable rental growth but falling net rents following incentives; and ii) a slow increase in vacancy rates (rather than drastic) as employers reassess working spaces amid the remote-working phenomenon.

For more information, refer to the corporate outlook for real estate (click here).

Corem is a medium-sized CRE company based in Sweden with a pro-forma (merged) core property value of SEK 73.1bn (EUR 7.1bn) and Scope-adjusted total assets of SEK 82.4bn (EUR 8.0bn) as of end March 2021. This compares favourably to Corem's standalone core property value of SEK 12.6bn (EUR 1.21bn) and Scope-adjusted total assets of SEK 17.1bn (EUR 1.64bn). The total lettable area of the merged company amounts to 3,432,000 sq m (vs 1,012,000 sq m standalone). In addition, the company has 2,100,000 sq m in unutilised commercial building rights, some of which it plans to use over the coming years. 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, and warrants good access to capital markets as shown by the regular issuances.

High market share in logistics and office

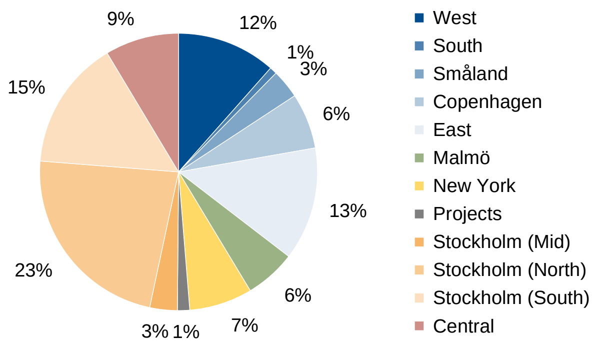
Corem's market position within logistics in Sweden is strong. In its core areas, Corem's portfolio by square metres is ranked first in north Stockholm, Jönköping, Gothenburg and Malmö and second in south Stockholm. Klövern's logistics exposure in Malmö is almost double that of Corem; the merger therefore makes Corem Sweden's third largest logistics property company. With the addition of Klövern's portfolio, Corem ranks mostly first or second for office space in the regional capitals and within the top 10 in Stockholm and Gothenburg. The moderate or dominant position in most areas and the high market share in the Swedish capital city are credit-positive, often providing higher visibility to potential new tenants and more opportunities to adapt to the changing need of existing ones. Thus, the high market shares increase tenant retention and yield a more stable occupancy in addition to reducing capex needs linked to tenant fluctuations.

Diversified across Sweden, with minor exposure abroad

Corem's geographical diversification is moderate, being active across Sweden (6 'Nuts 2' regions as classified by Eurostat within Sweden), with a small exposure across the Öresund strait in Copenhagen (7% market value) and in New York (7%). Thus Corem's performance hinges on the macroeconomic development of Sweden, a mature and stable economy with a strong welfare/social system. The latter takes the burden off employers in times of distress (as can be seen right now), with employees' labour costs predominantly borne by the state. In addition, the 'socialist' nature of the Swedish government has meant financial support has been readily provided to businesses in these exceptional times, through subsidies for their fixed costs (including rent). This allows them to continue almost normally, decreasing rental losses from tenants.

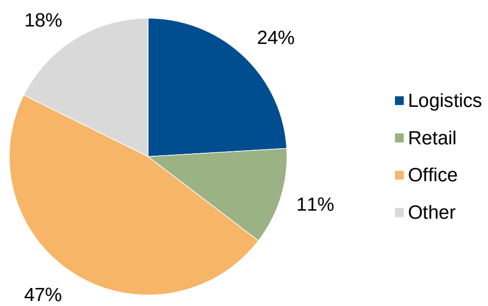
The company has 41% of its market value in Stockholm, followed by eastern Sweden (Linköping, Norrköping, Nyköping; 13%), western Sweden (mostly Gothenburg; 12%), central Sweden (9%), Malmö (6%), the Öresund strait (7%), the US city of New York (7%), and Småland (Jonköping; 3%). While Stockholm is dominant, it is important to highlight that northern/central Stockholm and southern Stockholm are essentially two logistics regions, due to subpar transportation links and other restrictions that make it difficult to traverse the two areas (one congested highway; Stockholm Bypass motorway expected to be complete only in 2030).

Figure 1: Geographic diversification by asset market value



Sources: Corem, Klövern, Scope

Figure 2: Asset diversification by rental income



Sources: Corem, Klövern, Scope

Merged Corem provides a more balanced portfolio

Corem's largest segment by rental value was logistics with 74%, followed by offices with 14%, and retail with 8%. For Klövern, these were offices with 56%, followed by retail with 12% and logistics with 10%. After the merger, the portfolio is no longer overweight in one property type but more balanced and diversified by rental income. Office accounts now for 47%, logistics 24%, retail 11% and the remaining exposure is towards a diversified educational/care home/hotel/parking portfolio.

Moderate tenant diversification, with good tenant quality

Corem's tenant diversification is assessed as moderate, with the top three accounting for 9% and the top 10 for 15%. The top three concentration is due to Ericsson, with 6.0% of total rent. Corem's top 20 tenants are investment grade, five of which are government agencies or companies (AA-AAA), with the sub-investment grade exceptions being two parking companies and a hotel group. With the merger, tenants have increased to around 4,900, from 700 for Corem standalone.

Overall tenant quality based on credit losses is low investment grade. As a result, we expect only a marginal risk of a significant deterioration in cash flows due to a single tenant's default or delayed payments.

Both companies undertook their refocussing strategies in 2019. Corem sold 31 properties in 14 locations it deemed non-core and acquired seven properties in core areas it perceives to be better locations, i.e. metropolitan areas with good access to transport infrastructure. Corem's portfolio is now centred on Stockholm with 57% of market value. Klövern also streamlined its portfolio, disposing of non-core B and C locations and concentrating on 10 Swedish cities. Klövern's portfolio now has 74% of market value in metropolitan regions with more than 1m inhabitants and is now focused on modern offices after divesting its warehouses and logistics premises.

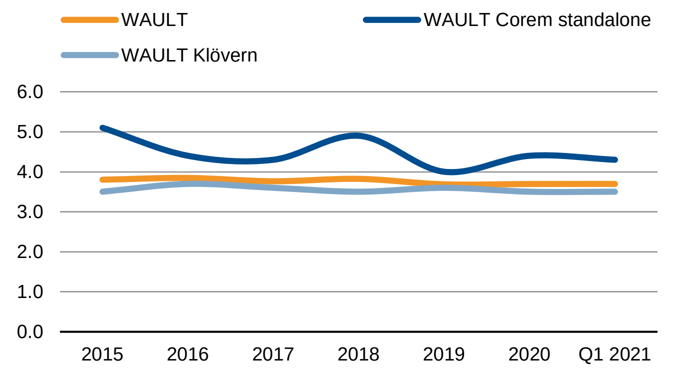
Attractive portfolio in predominantly 'A' locations for both logistics and offices

Corem's asset quality benefits from its large share of cities graded 'A' from the perspective of both investors and tenants, according to Scope's methodology. Stockholm, Malmö, Copenhagen and Gothenburg account for 87% of its logistics exposure. The office portfolio benefits from a 69% exposure to 'A' locations (Stockholm, Gothenburg, Malmö, Copenhagen and New York). The high share in large liquid markets is likely to result in good fungibility, meaning any haircuts on the portfolio would be limited should the company fall under distress and be forced to sell assets. A scenario of financial distress is remote given Corem's decent financial risk profile.

Below-average occupancy

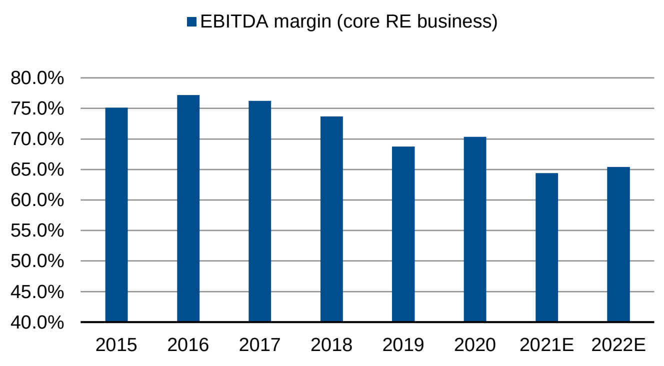
Both Corem's and Klövern's economic occupancy rates have fluctuated around 90%. As of March 2021, it was 93% for Corem and 88% for Klövern. Such levels, both standalone and combined, are relatively low for a traditional buy-and-hold company, especially for office space. Even so, we appreciate the reasoning behind the strategies and consider the stability of vacancies across the cycle to mitigate risks. Corem's management targets a greater increase in occupancy and profitability for the combined entity than in the previous growth stategy, which gives us comfort on the downside. The 'soft' merger synergies also give deeper knowledge and networks to Corem in hiring out office space and the same to Klövern as regards logistics.

Figure 3: WAULT (years)



Sources: Corem, Klövern, Scope

Figure 4: Profitability (%)



Sources: Corem, Klövern, Scope

Below-average WAULT, manageable reletting risk

Corem's pro-forma weighted average unexpired lease term (WAULT) of 3.7 years as of end March 2021 is short compared to European peers' and slightly below the Nordic peer average (four years), mostly hindered by Klövern's portfolio (3.5 years). This is mitigated by the stability of WAULT within countercyclical movements in offices and logistics in the last five years. As long as the economy is growing and tenant demand is healthy, re-letting risk will be manageable, even with 18% of Corem's rental income on average maturing yearly in 2021-24. However, Covid-19 and the changing logistics and office landscape are creating pressures to reduce rent when leases are extended, somewhat mitigated by new demand from strongly growing sectors like food delivery.

Profitability lowered through merger with Klövern

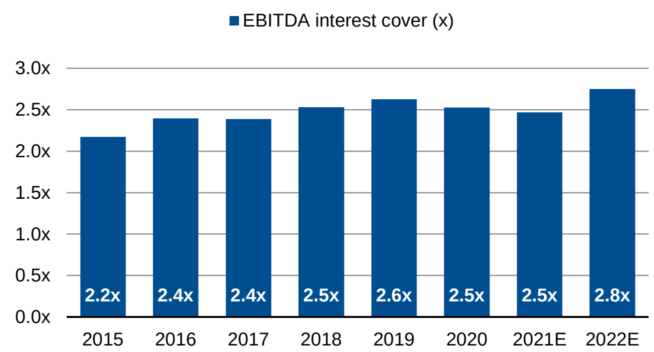
Corem's profitability is high among peers, at around 76% as measured by the Scope-adjusted EBITDA margin (including dividends from long-term holding Klövern in revenue/EBITDA). This reduced somewhat to around 70% during the recent streamlining. Going forward, we expect around 65%, weighed down by Klövern's lower margins (60%-65%).

Financial risk profile: BB+

Debt protection to improve from already strong levels

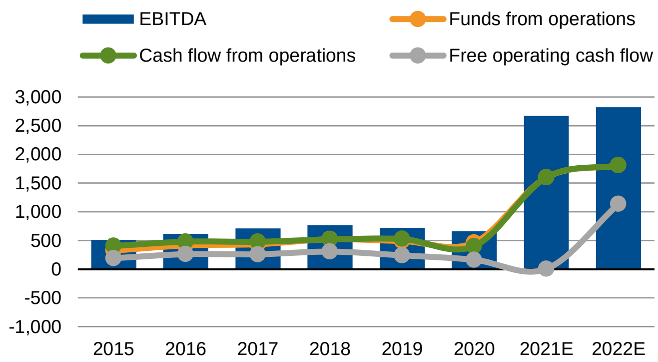
Corem's debt protection has been stable at around 2.5x. In line with the rest of the Nordic market, the company's preference for floating-rate debt, helped by record low interest rates, and short financing terms have resulted in low cash interest payments. We continue to project a low floating-rate profile for Corem and thus strong debt protection. We also highlight the significant hedged exposures: 70% of Corem's floating rates and more than 90% of Klövern's base rates. Assuming a stronger standing in capital markets after the merger and given Corem's stated ambition to be investment grade, our base case factors in a spread reduction for the refinancing in 2022 and 2023, lifting EBITDA interest cover towards 3x on our forecasts.

Figure 5: Scope-adjusted EBITDA interest cover (x)



Sources: Corem, Scope estimates

Figure 6: Cash flows (SEK m)



Sources: Corem, Scope estimates

Merger with Klövern lifts cash flows fourfold

The Scope-adjusted EBITDA of Corem has grown in line with asset growth, to SEK 770m in 2018 from SEK 510m in 2015. The portfolio streamlining and non-core disposals in the second half of 2019 had a negative effect on rental income and EBITDA, as shown in the 2020 numbers that relate to the ex-non-core portfolio (though slightly affected by Covid as well). In merging with Klövern, the proforma full-year 2021 EBITDA, funds from operations and cash flow from operations have risen fourfold but remain in tandem with the combined cash flow numbers. We expect some growth for cash flow once Corem's and Klövern's projects are complete and the minor forecasted acquisitions are finalised.

Free operating cash flow to remain positive…

Scope-adjusted free operating cash flow (excluding discretionary capex) has been positive for the five years to 2020. We forecast it to dip slightly in 2021 due to Klövern's investment programme (started, therefore no longer discretionary) but to recover quickly, based on our view that the company will be able to finance maintenance capex, including tenancy adaptations, with internal cash flows. Corem's streamlining in 2019 brought SEK 3.9bn in cash (discretionary), which was predominantly used for deleveraging and hence is credit-positive.

…with discretionary cash flow to also turn positive due to less expansion anticipated

Discretionary cash flows have been heavily impacted by property acquisitions over the last five years as well as developments of new and adapted properties on existing building rights. Discretionary cash flows were negative in all years except 2019, which we foresee to continue in 2021 with negative SEK 2.6bn. Thereafter, we forecast a focus on reducing vacancies and gradually increasing profitability, with less expansive growth resulting in slightly positive discretionary cash flows.

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

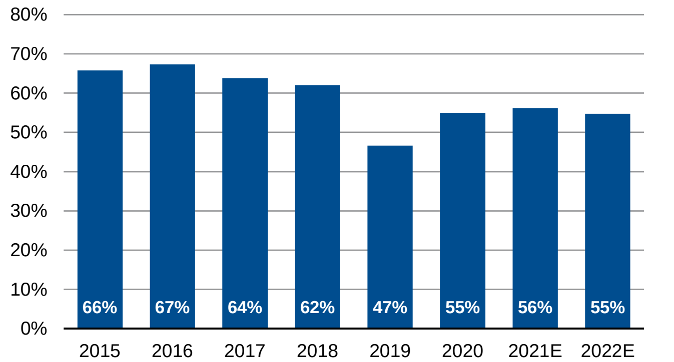
In 2020, deleveraging reversed with i) heavy investment into property development on existing building rights, in addition to smaller acquisitions; ii) share buybacks totaling SEK 498m; and iii) the Covid-19 effect on equity markets, which reduced the value of its long and short-term share portfolio by around 30%. Leverage as of YE 2020 was 55%.

Deleveraging in both companies to result in overall decrease in LTV

Our base case assumes deleveraging after the merger, based on the expected decrease in both standalone companies' LTVs by 1% yearly during the forecast period. For Klövern, this is based on i) value-accreditive developments (e.g. in New York); and ii) our expectation of plateauing growth in interest-bearing debt as the ongoing capex programme ends. We consider Corem's toned-down growth target to help with deleveraging, even with our cautious approach to assume limited fair value appreciations.

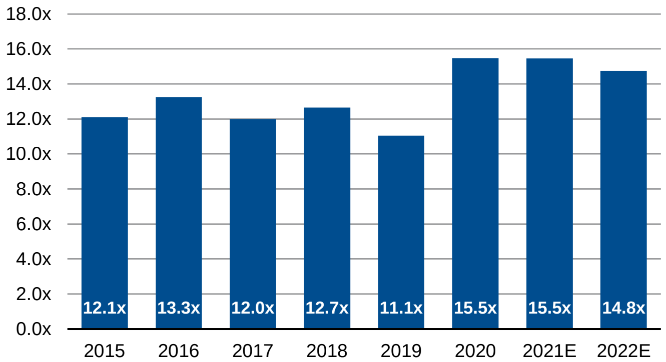
Pre-merger, Corem's significant balance sheet exposure to listed real estate shares (especially to Klövern) led to an LTV that was much more sensitive to changes in market sentiment than among traditional real estate companies, whose valuations are driven by yield/rental income changes. The reduction of that volatility (through merging) is credit-positive.

Figure 7: Scope-adjusted loan/value ratio (%)



Sources: Scope estimates

Figure 8: SaD/SaEBITDA (x)



Source: Scope estimates

Scope-adjusted debt to EBITDA has remained stable at around 11-13x in the last years. We foresee an increase to 15-17x due to the merger with Klövern, whose SaD/EBITDA is 17-18x (including a hybrid bond issuance of SEK 1.3bn, of which 50% is considered equity under our methodology). As the company is predominantly active in buy-and-hold logistics and office properties, we do not apply weight on this ratio.

Corem, like most Nordic peers, relies on short-term funding. Excess liquidity is invested in marketable securities, namely listed equities of Swedish real estate peers. Short-term funding needs are covered by either revolving credit facilities and cheque credit facilities, or the disposal of marketable securities, while secured bank debt and unsecured bonds cover long-term needs.

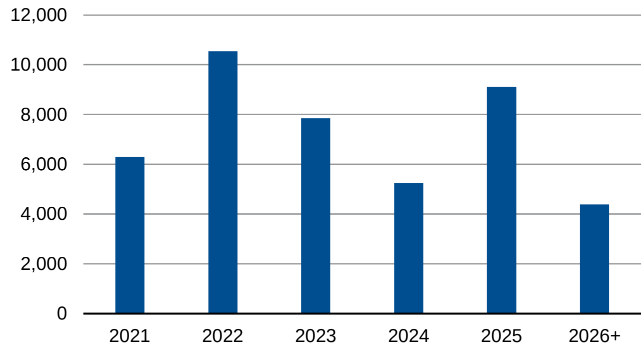
At end March 2021, the secured LTV was 43%, giving ample possibility to increase debt on existing properties, as the company permits up to a 70% LTV on bank loans in case the short-term market prevents refinancing. This situation is mirrored at Klövern: a secured LTV of 33% against a maximum of 60% on bank loans.

Adequate liquidity

The merged company's next unsecured maturity is a SEK 2.5bn green unsecured bond in April 2022 (from Klövern). In the unlikely case the company cannot refinance the bond, the SEK 4.6bn of undrawn facilities can still cover it.

We assess a low likelihood of banks not refinancing the secured loans pledged in real estate as Corem's LTVs are all below the banks' requirements. The company enjoys good relationships with all large Nordic banks, shown by the loans with various maturities.

Figure 9: Maturity profile (SEK m)



Sources: Corem, Klövern, Scope

Figure 10: Liquidity

Corem (SEK bn)	2021E	2022E
Short-term debt (t-1)	4.1	10.4
Unrestricted cash (t-1)	0.0	0.5
Marketable securities (t-1)	1.7	1.7
Open committed credit lines (t-1)	0.9	4.6
Free operating cash flow (t)[1]	0.4	0.3
Coverage	**0.6x**	**0.8x**

Source: Scope estimates

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

Appendix I: Peer comparison

	Corem Property Group AB	Klövern AB	Fastpartner AB	Globe Trade Centre S.A.	Deutsche Konsum REIT-AG
	BBB-/Stable	BBB-/Stable/--	BBB-/Stable	BBB-/Stable/--	BB+/Stable/--
As of reporting date	2021-03-31	2020-12-31	2020-12-31	2020-12-31	2020-12-31
Business risk profile	proforma merged				
Scope-adjusted total assets (EUR m)	8,044	6,121	3,018	2,198	935
Portfolio yield	5.8%	5.3%	4.6%	6.9%	5.9%
Gross lettable area (thousand sq m)	3,432	2,549	1,535	753	917
No. of residential units	na	na	na	na	na
No. of countries active in	3	3	1	6	1
Top three tenants (%)	9%	11%	9%	14%	36%
Top 10 tenants (%)	15%	19%	19%	26%	56%
Office (share of net rental income [NRI])	47%	73%	49%	65%	na
Retail (share NRI)	11%	13%	12%	35%	100%
Residential (share NRI)	na	0%	1%	na	na
Hotel (share NRI)	na	3%	2%	na	na
Logistics (share NRI)	24%	11%	16%	na	na
Others (share NRI)	18%	0%	20%	na	na
Property location	‘A’ and 'B'	‘A’ and ‘B’	‘A’	'B'	‘B’
EPRA occupancy rate (%)	89%	90%	91%	91%	97%
WAULT (years)	3.7	3.5	4.7	2.9	5.5
Tenant sales growth (%)	na	na	na	na	na
Like-for-like rent growth (%)	na	na	na	-16.0%	0.9%
Occupancy cost ratio (%)	na	na	na	na	na
Scope-adjusted EBITDA margin[2]	65%	62%	68%	87%	64%
EPRA cost ratio (incl. vacancy)	na	na	na	na	28.3%
EPRA cost ratio (excl. vacancy)	na	na	na	na	25.8%
Financial risk profile	proforma merged				
Scope-adjusted EBITDA interest cover (x)[8]	2.5x	2.4x	3.7x	3.3x	4.7x
LTV (%)	55%	54%	49%	48%	50%
Scope-adjusted debt/Scope-adjusted EBITDA (x)[8]	15.5x	17.0x	12.4x	10.0x	12.1x
Weighted average cost of debt (%)	2.5%	2.4%	2.0%	2.3%	1.9%
Unencumbered asset ratio (%)	na	na	190%	364%	190%
Weighted average maturity (years)	na	4.3	3.2	4.2	3.8

*Scope subscription ratings available on ScopeOne

[2] includes all gross lettable area both above and below ground

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