

Research Update:

# Sweden-Headquartered Humlegården Fastigheter AB Assigned 'BBB+' Rating; Outlook Stable

February 14, 2022

## Rating Action Overview

- Humlegården Fastigheter AB owns and manages commercial property valued at about Swedish krona (SEK)36.8 billion (€3.5 billion) as of June 30, 2021, mainly comprising high-quality office buildings in central Stockholm that should benefit from limited new supply despite increasing work-from-home trends.
- The company also has a prudent financial policy, maintaining low debt leverage and strong interest coverage compared with the industry standards.
- We expect that Humlegården's owner, Länsförsäkringar Alliance, will provide extraordinary support in some foreseeable circumstances, and therefore we add one notch of uplift to our 'bbb' assessment of Humlegården's stand-alone credit profile.
- We therefore assigned our 'BBB+' long-term issuer credit rating to Humlegården.
- The stable outlook reflects our anticipation that Humlegården's portfolio should continue to attract tenant demand and generate predictable cash flows over the next few years, such that S&P Global Ratings-adjusted debt to debt plus equity improves below 40% and interest coverage remains above 4.5x.

## Rating Action Rationale

**Our rating reflects Humlegården's well-spread leases across creditworthy tenants, which partly mitigate a moderate portfolio size and some geographic and segment concentration.**

Humlegården has a high-quality property portfolio valued at SEK36.8 billion as of June 30, 2021 with the majority of premises located in central parts of Sweden's capital Stockholm. About 45% of the property value is in the inner city, and the remainder in adjacent areas (20% in Gärdet/Hagastaden and 35% in Solna Strand or other areas) with supportive demand-supply dynamics that should continue to support occupancy rates. Humlegården's portfolio size remains moderate relative to that of other rated real estate companies in Europe, but the company enjoys a solid position in its local market, being among the top players in Sweden's prime office market. Although the duration of Humlegården's commercial lease contract portfolio is somewhat short,

### PRIMARY CREDIT ANALYST

**Teresa Stromberg**  
Stockholm  
(46) 8-440-5922  
teresa.stromberg  
@spglobal.com

### SECONDARY CONTACTS

**Franck Delage**  
Paris  
+ 33 14 420 6778  
franck.delage  
@spglobal.com

**Marie-Aude Vialle**  
Paris  
+33 6 15 66 90 56  
marie-aude.vialle  
@spglobal.com

### ADDITIONAL CONTACT

**Industrial Ratings Europe**  
Corporate\_Admin\_London  
@spglobal.com

4.7 years, compared with that for certain other rated European peers such as Alstria Office REIT AG (6.2 years) or Befimmo SA (7.2 years), Humlegården's tenant retention rate is high and contract break option dates are relatively well spread out, which lessens the company's exposure to significant renegotiation risk.

**In general, the company's tenants comprise a broad range of entities, including insurance companies, public authorities, law firms, media firms, and investment banks.** We note some concentration, since the largest tenant, Länsförsäkringar AB (A/Stable/A-1) accounts for almost 10% of rental income and the 10 largest tenants account for 35%-40% of revenue, although this is well in line with peers within the same rating category and the top tenants display strong creditworthiness. That said, the company has low geographic diversification, due to its concentration in Stockholm city. In addition, Humlegården's portfolio consists primarily of commercial properties, mainly offices (84% of property portfolio), retail (6%), and other (10%), which we view as less resilient than for instance, residential or community service properties.

**Humlegården's strong asset quality, high environmental standards, and central location should help it withstand changing office segment dynamics and remote-working trends due to COVID-19.** So far, the pandemic and rollout of work from home processes have had a limited impact on Humlegården's occupancy, and most of its tenants have been paying their rent despite lower space utilization. In 2020, the company showed a slight decline of only 1% in like-for-like rental income due to somewhat softer take up in the wake of COVID-19, resulting in a slightly higher vacancy rate. But in the first half of 2021, a positive trend resumed in line with recent years, with like-for-like rental growth of 4% combined with a positive asset revaluation. Yet, we believe it is too early to draw conclusions about the long-term effect of employees working from home on the total volume of leasing transactions in the Swedish office market as tenants revise their needs along with their lease maturities. We therefore anticipate that remote working will continue to reduce demand for office space. In our view, high service, centrally located office assets will fare better than more remotely located office premises where vacancies and available supply are higher. Subsequently, we believe that Humlegården is well positioned, given its more centrally located offices, where vacancy and supply are often more limited and barriers to entry (mainly building permissions and renovation costs) are higher. Furthermore, we note that Humlegården is well advanced in terms of sustainability standards, with 91% of the gross leasing area certified according to BREEAM or locally from Miljöbyggnad (Sweden's Green Building Council) as of June 2021. This provides the company with a competitive advantage, since we think tenants' and investors' demand is increasingly focusing on green assets. Overall, we believe the company will be able to absorb a decline in demand for office space during the short to medium term and adapt to changing office dynamics, supported by its prime asset locations.

**Supportive market fundamentals should fuel organic growth for Humlegården's properties over the next 12-24 months.** We regard GDP growth, job creation, and the consumer price index (CPI) among the most important macroeconomic factors supporting rents for office property owners. We expect the unemployment rate in Sweden to fall to 7.5% in 2022 and 7.0% in 2023 with GDP growth at 3.3% and 2.4%, respectively. Thereby, we expect positive rental growth prospects due to improving macroeconomic conditions and supportive segment fundamentals, with inflation expected at 1.9% in 2022-2023, supporting rent indexation. In addition, we forecast some slight improvement in Humlegården's occupancy rate in the short term, from 93.5% (excluding properties under development and signed leases) as of Dec. 31, 2021. During 2021, the company managed to sign new contracts at higher rent levels (of around 20%), partly mitigating the negative impact of lower take-up volume. Due to COVID-19 and the continued work from home

trend, our forecast incorporates a cautious view about the releasing of expiring contracts.

**Humlegården should continue expanding its portfolio moderately and prudently in the next 12-24 months, in line with its growth strategy and track record.** The portfolio expanded to SEK36.8 billion as of June 30, 2021, from SEK26.1 billion as of June 30, 2019, mainly following the acquisition of properties in central Stockholm of about SEK6.0 billion in 2019, in addition to positive asset revaluations. We assume the property portfolio will increase modestly to SEK39 billion-SEK40 billion by year-end 2023. We anticipate that the company will target acquisition of properties for SEK1 billion-SEK2 billion a year primarily within the same geographic areas as the existing portfolio. We also anticipate that the company will use a balanced mix of debt and equity to fund its future growth, and so maintain low leverage as per its prudent financial policy. In addition, Humlegården has two development projects outstanding with a total volume of SEK1.7 billion, of which SEK1.2 billion will be completed over the next 12-18 months. The company mitigates the speculative element of developments by pre-letting and carrying out construction work in phases.

**We expect Humlegården's leverage ratios to strengthen slightly over the next two years, in line with its financial policy.** Our assessment of Humlegården's financial risk profile is based on the company's debt to debt plus equity ratio of 41.3% as of June 30, 2021, corresponding to reported loan to value of 36.0%, as well as solid EBITDA interest coverage ratio of 4.5x-5.5x, based on a low cost of debt of 1.5%, on that date. We forecast the company's leverage ratios will improve slightly in the next 12-24 months, with S&P Global Ratings-adjusted debt to debt plus equity falling to 37%-38%. This would be also in line with the company's plans to operate with leverage below 40% (even though its financial policy only requires a loan-to-value ratio below 50%). Our assessment also takes into account the company's debt to EBITDA of 11.6x as of June 30, 2021, but we expect the ratio to fall to 10.5x-11.5x from 2023, assuming a higher operating result and lower investment volume compared with those in 2021 and 2022. The company's capital structure is largely unsecured and had a weighted average debt maturity profile of 3.9 years as of June 2021.

**Humlegården has moderate leverage and strong interest coverage relative to peers' and industry standards, supporting a notch of uplift.** Our long-term rating on Humlegården incorporates one notch of uplift based on our comparable ratings analysis. Compared with peers in a similar financial risk profile category, especially those operating in low-yield environments, Humlegården's leverage metrics appear better positioned, supported by an interest coverage ratio higher than 5x, debt to debt plus equity improving below 40%, and debt to EBITDA moving below 11x in our forecast. This positions Humlegården in the better end of the intermediate financial risk profile category. In addition, we expect its sole owner Länsförsäkringar Alliance (LF Alliance) will continue to support Humlegården on an ongoing basis with potentially additional equity contributions in the future, which may be used for acquisitions and new project capital expenditure requirements although not committed at this stage. This should help the company expand its portfolio while maintaining financial discipline in line with our current ratings.

**Humlegården is likely to receive extraordinary support from owner, LF Alliance, in some foreseeable circumstances given LF Alliance's long-term holding strategy, thus reinforcing its overall creditworthiness, in our view.** Humlegården is 100% owned and controlled by Swedish insurance group LF Alliance, which we view as potentially more creditworthy. LF Alliance is Sweden's leading non-life insurer, and core entities include non-life insurer Länsförsäkringar AB (A/Stable/A-1), Länsförsäkringar Liv AB, and Länsförsäkringar Bank; Humlegården represents part of LF Alliance's investments in real estate. We assess Humlegården as a moderately strategic

subsidiary and expect the parent to assist the company if it experienced financial difficulty. Accordingly, our rating on Humlegården incorporates a one-notch uplift from our assessment of the company's 'bbb' stand-alone credit profile based on our group rating methodology. We understand that LF Alliance considers Humlegården a long-term investment that is unlikely to be sold. LF Alliance has owned Humlegården since 1999. Humlegården holds a contractual agreement whereby LF Alliance commits to subscribing to commercial paper up to SEK1.6 billion should Humlegården fail to issue in the capital markets. The agreement has a rolling 24-month maturity. This in our view provides the company with a useful liquidity buffer and diminishes refinancing risk. This is also supported by financial covenants in Humlegården's loan agreements; they contain a change of control clause, which is triggered when the aggregate holdings of LF Alliance cease to represent at least 90% of the total voting rights in Humlegården as represented by the shares. While Humlegården doesn't operate as an integrated division of LF Alliance and doesn't share the same brand identity and image, we see the company as a privileged vehicle for LF Alliance when investing in core offices in central Stockholm through equity shares. In our view, Humlegården fits well within the scope of LF Alliance's overall investment guidelines and it has limited correlation with the LF Alliance's other investments in equities and fixed income securities.

## **Outlook**

The stable outlook reflects our view that Humlegården's property portfolio will continue to generate stable cash flow over the next two years, thanks to improving macroeconomic fundamentals in Sweden and ongoing demand for high-quality office assets focusing on centrally located offices in Stockholm, despite the increasing work-from-home trend.

We expect Humlegården to maintain prudent financial discipline and moderate growth, such that its EBITDA interest coverage will remain above 4.5x, and debt to debt plus equity improves sustainably below 40% with debt to EBITDA staying at 11x-12x over the next two years.

We would expect Humlegården to continue to moderately expand its portfolio in line with its growth strategy, while exhibiting financial discipline. We expect like-for-like rental income will increase by approximately 1.5%-2.0% in the next 12-24 months.

## **Downside scenario**

We could lower the rating if Humlegården's credit metrics deteriorate more than we anticipate with:

- Adjusted debt to debt plus equity failing to remain sustainably below 40%;
- Debt to annualized EBITDA deviating materially from our current base case, which could occur following higher-than-expected debt-financed acquisitions or investments, or materially weaker operating performance than our forecast; or
- S&P Global Ratings-adjusted EBITDA interest coverage falls close to 3.8x.

## **Upside scenario**

We could raise the ratings on Humlegården if:

- S&P Global Ratings-adjusted debt to debt plus equity improves to well below 35% on a sustainable basis, as a result of a change in Humlegården's financial policy.

- The company's debt to EBITDA falls to well below 9.5x while the EBITDA interest coverage ratio remains comfortably above 4.5x.

Rating upside would also depend upon Humlegården improving its portfolio's scale and tenant diversity with assets of similar quality and underlying market dynamics, so that it becomes more aligned with that of other higher-rated commercial real estate peers

Although unlikely at this stage, we could also consider raising the rating on Humlegården if there is a strengthening of the LF Alliance's long-term commitment to its investment in Humlegården, for example if the two entities were to become more integrated.

## Company Description

Humlegården is a Swedish private real estate company that owns and manages a property portfolio worth SEK36.8 billion as of June 30, 2021, with gross leasable area of 537,444 square meters and an average yield of 4.0%. The company focuses on centrally located properties in Stockholm city and adjacent areas close to public transportation. The company has a major focus on offices (84% of property value as of June 30, 2021) with some retail assets (6%) and other properties including project development (10%).

Humlegården is 100% owned by entities within the LF Alliance. LF Alliance consists of 23 regional mutual insurers (78.6%), Länsförsäkringar AB (7.5%; A/Stable/A-2), Länsförsäkringar Liv (13.2%), and Länsförsäkringar Fondliv (0.7%). LF Alliance (founded in 1873) is Sweden's largest non-life insurance alliance with a well-known brand, 3.9 million customers, and strong capitalization.

## Our Base-Case Scenario

### Assumptions

- GDP growth in Sweden of 3.3% in 2022, following a 3.8% expansion in 2021. The recovery of economic output last year will result in a slight decrease in the unemployment rate to 7.5% in 2022 from 8.2% in 2021. We estimate consumer price inflation growth of 1.9% in 2022 and 2023.
- Positive like-for-like rental income growth of 2.0%-2.5% per year in 2022-2023 supported by rent indexation and renegotiations, as demand for office space recovers over the next two years.
- An occupancy rate of 93%-94% for the next two years, reflecting stable demand anticipated for Humlegården's assets and an average lease duration of 4.7 years.
- A flat portfolio revaluation in 2022-2023, supported by low indexation and conservative assumptions on yield developments.
- Stable EBITDA margins of about 73%-74%, resulting from a higher EBITDA base, stable fixed costs, and partially offset by some higher costs related to redevelopment activities.
- Capital expenditure of approximately SEK700 million-SEK800 million annually in 2022 and 2023, in line with the company's strategy.
- Acquisitions of SEK2 billion each year in 2022 and 2023 in line with the company's growth target.

- Average cost of debt to remain stable at 1.5%-1.6%.

## **Key metrics**

Based on these assumptions, we arrive at the following credit measures over the next 12-24 months:

- EBITDA to interest coverage of about 5.0x-6.0x;
- Adjusted debt to debt plus equity at about 37%-38%; and
- Debt to EBITDA of close to 11.0x.

## **Liquidity**

Our assessment of Humlegården's liquidity profile as adequate is supported by the company's access to committed available lines. We forecast that the company's liquidity sources will exceed its funding needs by 1.7x over the next 12-24 months.

Principal liquidity sources:

- Cash and equivalents of SEK301 million as of Sept. 30, 2021.
- SEK2.2 billion of committed available bank lines maturing beyond 12 months, including the LF Alliance's guarantee of SEK1.6 billion
- Expected funds from operations of about SEK750 million for the next 12 months.
- No committed asset sales.

Principal liquidity uses:

- Committed capital expenditure of SEK515 million for the next 12 months.
- No committed acquisitions
- Debt maturity of SEK1.5 billion in the following 12 months.
- No dividend payments.

## **Covenants**

### **Compliance expectations**

Humlegården has covenants under its outstanding bank debt and credit lines. We understand that the headroom under these covenants is significant, at more than 30%. We expect Humlegården to maintain sufficient headroom under all outstanding and future financial covenants.

### **Requirements**

Main financial bank covenants for Humlegården:

- Loan-to-value ratio of no more than 70% (36% as of June 30, 2021).

- Interest coverage ratio above 2.0 (4.9x as of June 30, 2021).

Loan documents contain a clause saying that loans would become redeemable should LF Alliance's ownership of Humlegården go below 90%.

## **Environmental, Social, And Governance**

### **ESG credit indicators: E-2, S-2, G-2**

ESG factors are an overall neutral consideration in our credit rating analysis of Humlegården. We believe that the company is well advanced in terms of certification of its buildings; in June 2021, 91% of its gross leasing area was classified according to BREEAM or LEED sustainability assessments, including 65% "Very Good" and 8% "Excellent." We believe the company's strategy is well aligned with the increasing demand from tenants and investors for sustainable or green buildings and rising awareness across the real estate industry for environmentally certified assets and reduced carbon footprints, although it remains slightly behind French office peer Société Foncière Lyonnaise, whose assets are all scored at least "Very Good." In addition, the company had 100% green financing at year-end 2021. We also recognize that the company targets to become climate neutral by 2045, by reducing energy consumption of its properties (in kilowatt-hour per square meter) by 32% between 2008 and 2030.

## **Ratings Score Snapshot**

Issuer Credit Rating: BBB+/Stable/--

Business risk:

- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk:

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb

- Group credit profile: a

- Entity status within group: Moderately strategic (+1 notch from SACP)

## Related Criteria

- 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
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

### New Rating

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#### Humlegarden Fastigheter AB

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Issuer Credit Rating BBB+/Stable/--

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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