Research Update:

Netherlands-Based Vesteda Residential Fund FGR Upgraded To 'A-' On Strong Financial Discipline; Outlook Stable

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PRIMARY CREDIT ANALYST

Manish Kejriwal
Dublin
+ 353 (0)1 568 0609
manish.kejriwal
@spglobal.com

SECONDARY CONTACT

Nicole Reinhardt
Frankfurt
+ 49 693 399 9303
nicole.reinhardt
@spglobal.com

Rating Action Overview

- Vesteda Residential Fund FGR (Vesteda) has shown strong financial discipline in the past few years, with sustained low leverage and S&P Global Ratings-adjusted debt to debt plus equity below 30% (24.7% as of Dec. 31, 2020) since 2015. This is in line with its conservative financial policy of maintaining leverage--defined as reported net debt to total assets (excluding International Financial Reporting Standard 16 [IFRS 16])--below 30%.
- The company has reported solid operational performance with very limited impact from the COVID-19 pandemic, maintaining positive like-for-like rental and value growth and high occupancy levels.
- We raised our long-term issuer credit rating on Vesteda to 'A-'. We also raised our issue ratings on the company's senior unsecured debt to 'A-'.
- The stable outlook reflects our expectations that Vesteda should continue benefiting from stable rental income thanks to its high occupancy levels and the favorable dynamics of the Dutch housing market. We expect the group will maintain adjusted debt to debt plus equity of 25%-28%, debt to EBITDA of about 9.0x-9.5x, and EBITDA interest coverage well above 5x over the next 12-24 months.

Rating Action Rationale

Our rating action follows Vesteda's strong track record of financial discipline with very low leverage over the past six years. The company has a publicly stated financial policy of maintaining a net debt to total assets (excluding IFRS 16) ratio of less than 30%. This is in line with the adjusted ratio of debt to debt plus equity, which has been less than 30% on average since 2015 (24.7% as of Dec. 31, 2020). We understand the fund would temporarily allow leverage of up to 40%. However, this might only happen under a scenario where property market values fall significantly, which is not our base-case scenario. We also understand that in such a scenario, Vesteda would have several options to reduce its leverage back to below 30%. The company's strong credit metrics are also supported by the pandemic's very limited effect on its operational performance, thanks to the resilience and nature of the residential real estate segment, which has high tenant and asset diversification. The company reported adjusted debt to EBITDA of 9.0x and a very high EBITDA interest coverage ratio of 5.6x in 2020. We forecast that the company's credit metrics will remain broadly stable, with sufficient headroom under its maximum leverage target and within its financial policy. We expect the company's debt to debt plus equity will be 25%-28% in the coming 12-24 months. In addition, we anticipate Vesteda will continue benefiting from the low interest-rate environment, reporting an EBITDA interest coverage ratio well above 5.0x and stable debt to EBITDA at approximately 9.0x-9.5x for the next 12-24 months. Vesteda's capital structure belongs to the most conservative financial risk profile under our rated residential real estate portfolio in Europe.

Vesteda's residential portfolio continues benefiting from the Dutch housing market's solid fundamentals, but the company's portfolio remains small in scale and scope compared to other 'A-' rated peers. Like-for-like rental income increased by 2.7% in 2020 following a 3.6% increase in 2019, thanks to re-letting activities (0.3%) and an average annual rent increase for in-place tenants (2.4%). The lower growth compared to 2019 is mainly due to the pandemic and Vesteda's decision to moderate rent growth for in-place tenants. The majority of Vesteda's portfolio is located in Randstad, the region in the Netherlands with the most growth potential. We think low but positive inflation expectations and solid demand in this region will support rental growth of about 2%-3% over the next 12-24 months. We expect the good demand trends will keep occupancy rates high at above 95% (2020: 97.5%) Overall, our rating assessment takes into account the good size of the company's residential portfolio, totaling €8.4 billion--including €194 million of investment property under construction--at year-end 2020. This marks an increase of more than 15% over the past couple of years, from €7.3 billion at end-2018. That said, the company is small in scale and scope compared to rated peers, with a geographical concentration and hence dependency on a single economy, the Netherlands. For example, its portfolio is smaller than those of rated residential peers in the same business risk category, such as Deutsche Wohnen SE (about €28 billion) and Akelius (€12 billion), as well as other commercial peers at the 'A-' level, such as Prologis European Logistics Fund, FCP-FIS (€13.3 billion) and Gecina SA (€19.7 billion as of Dec. 31, 2020).

Vesteda's liquidity profile remains strong. We expect the company will keep sufficient liquidity under its revolving credit facility (RCF) of €700 million--fully undrawn as of March 31, 2021--and address upcoming refinancing needs, such as the €300 million bond maturing in October 2022, well in advance. The company's average debt maturity profile stood at 4.9 years as of Dec. 31, 2020, with a low average interest cost of 1.9%. In October 2020, Vesteda issued its first green private placements of two €50 million notes, for the terms of 10 and 15 years, with interest rates of 1.03% and 1.38%, respectively. We understand Vesteda will primarily use the proceeds to finance its project development pipeline, as well as to partly refinance the €100 million private placement maturing in May 2021. In December 2020, Vesteda also signed a €150 million term loan agreement, with a term of 10 years, with the European Investment Bank (EIB). Vesteda will primarily use this to fund projects in the regulated midsegment, as well as to improve the quality of its existing assets.

Outlook

The stable outlook reflects our view that Vesteda should continue benefiting from stable rental income thanks to its high occupancy levels and the favorable dynamics of the Dutch housing market. We anticipate that Vesteda will maintain its adjusted ratio of debt to debt plus equity at about 26%-28%, debt to EBITDA at about 9.0x-9.5x, and EBITDA interest coverage well above 5x, over the next 12-24 months.

Downside scenario

We could lower the rating if Vesteda's:

- Debt to debt plus equity increases sustainably to 30% or above as part of a revised financial policy; or
- The company fails to maintain debt to annualized EBITDA below or close to 9.5x.

This could occur if the company considers large debt-financed acquisitions, or much higher capital expenditure (capex) than we anticipate. This could also occur if Vesteda experiences significant negative portfolio revaluations.

We have slightly adjusted our threshold for the debt to debt plus equity ratio for the 'A-' rating of Vesteda. This aligns it closer to other rated residential real estate peers and reflects the resilience of the residential real estate market compared to other real estate segments.

Upside scenario

Rating upside is currently limited unless Vesteda significantly expands its portfolio's scale and scope so that it becomes more aligned with higher-rated peers', while maintaining its current financial policy and credit metrics. Such an expansion would also result in stronger portfolio diversification to markets and regions with favorable demand-supply trends and solid demographic prospects.

Company Description

Vesteda is one of the largest unlisted Dutch investment funds. It focuses on residential properties in the midmarket unregulated sector (66% of portfolio value as of Dec. 31, 2020), with limited exposure to the higher rent segment (28%) and regulated rents (6%). As of Dec. 31, 2020, the portfolio comprised 27,482 residential units, valued at €8.2 billion.

Our Base-Case Scenario

Assumptions

- Like-for-like growth in rental income of 2%-3% in the next 12-24 months, based on the company's expectation to increase its annual rent by the consumer price index plus 1% for the unregulated segment. Our assumptions further consider our expectations of pickup in Netherland's real GDP growth in 2021-2022 to about 3.0%-3.5% following a contraction of

3.8% in 2020, and positive inflation of 1.5%-2.0%. We assume occupancy will remain broadly stable at about 96%-98% in 2021-2022, supported by the favorable demand-supply dynamics of the Dutch residential real estate market.

- EBITDA margin to remain at 67%-68%, based on gross rental income.
- Capex for construction and development of €140 million-€150 million for the next 12 months.
- Conservatively, a portfolio revaluation of about 1%-3% in 2021-2022, with recent transfer tax regulation changes having a limited effect on the company.
- Stable average cost of debt of about 1.9%-2.0%.
- Dividend payout in 2021 of €180 million-€190 million.

Key metrics

	2020a	2021e	2022f
EBITDA interest coverage (x)	5.6	5.5-6.0	5.5-6.0
Debt to debt plus equity (%)	24.7	25.0-27.0	26.0-28.0
Debt to EBITDA (x)	9.0	9.0-9.5	9.0-9.5

a--Actual. e--Estimate. f--Forecast.

Liquidity

Our short-term rating on Vesteda is 'A-2'. We view the fund's liquidity as strong, including a stress scenario under which EBITDA declines by 15%. We forecast that liquidity sources will exceed uses by at least 1.5x over the next 12-24 months.

The company benefits from sufficient undrawn committed RCF and limited upcoming debt maturities.

We expect principal liquidity sources for the 12 months from March 31, 2021 will include:

- About €5.6 million of unrestricted cash and about €700 million available under the RCF agreement;
- About €74 million available under an EIB loan to fund project developments and capex of existing assets;
- Our forecast of €200 million-€210 million of cash funds from operations; and
- About €6.5 million from contracted asset sales.

We expect principal liquidity uses for the same period will include:

- €305 million of maturing debt, including €205 million of commercial paper and €100 million of private placement;
- €140 million-€150 million of capex, including for its project development pipeline; and
- €180 million-€190 million of cash dividend payments.

Covenants

As of March 31, 2021, Vesteda had significant headroom of more than 30% under all its financial maintenance covenants.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2020, the fund's capital structure comprised solely unsecured debt. All Vesteda's debt is issued under the company's financing entity, Vesteda Finance B.V.

Analytical conclusions

We rate the senior unsecured bond 'A-', in line with the issuer credit rating. This is because the company's exposure to secured debt is remote.

Ratings Score Snapshot

Issuer Credit Rating: A-/Stable/A-2

Business risk: Strong

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers

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

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

Ratings List

Upgraded

	To	From
Vesteda Residential Fund FGR		
Vesteda Finance B.V.		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
Vesteda Finance B.V.		
Senior Unsecured	A-	BBB+