Moody's affirms Castellum's Baa3 rating, outlook stable

Rating Action | *6 min read*

18 Dec 2023 Moody's Investors Service

Stockholm, December 18, 2023 -- Moody's Investors Service (Moody's) has today affirmed the Swedish real estate company Castellum AB's (Castellum or the company) long-term issuer rating of Baa3, its senior unsecured medium term note (MTN) ratings of (P)Baa3, its senior unsecured euro medium term notes rating at Baa3 and its subordinate debt rating Ba2. Concurrently, Moody's has also affirmed Castellum Helsinki Finance Holding ABP's backed senior unsecured euro medium term notes at Baa3 and its backed senior unsecured medium term note programme (MTN) ratings of (P)Baa3. The outlook for Castellum remains stable.

"Castellum's Baa3 rating has been affirmed as a reflection of the company's good rental growth, an adequate liquidity profile and good access to bank financing and bond markets, while rising interest costs pressure the company's interest coverage ratio ", says Maria Gillholm, Moody's lead analyst for Castellum. "While interest coverage is weakening, Castellum has during the year done a guaranteed SEK 10 billion equity raise in addition to several other credit protection measures to safeguard its credit profile in a much weaker operating environment following the significant rise in interest rates which is showing commitment to the rating", Mrs. Gillholm continues.

The affirmation of the Baa3 rating continues to reflect Castellum's good asset quality of its SEK 145 billion property portfolios diversified position in the Swedish real estate market with presence in Denmark and Finland. We expect Castellum to repay debt and keep Moody's-adjusted debt/asset well below 45%, despite further expected property value declines. About SEK 19.7 billion or 30% of its total debt will be refinanced during the next coming 18 months and will weaken the interest coverage further to 2.5x in end of 2023 but then improve to 2.8x for 2024 because of de-leveraging, cost efficiencies and a lower expected interest rate level.

RATINGS RATIONALE

The affirmation reflects Castellum's large diversified position in the Swedish real estate market with a presence in Government of Denmark (Aaa stable) and Government of Finland (Aa1 stable); its strong positions in the office markets in which it operates, including significant holdings in Stockholm and Gothenburg, while most of the warehouse/logistics assets are in some of Sweden's largest logistic hubs, including Gothenburg, Stockholm and Ã–rebro; its significant exposure (25%) to government tenants, which provide for a stable cash-flow stream on a long-term basis; and its adequate short-term liquidity and good track record of access to local capital markets. Its commitment to the rating which has led to a guaranteed SEK 10 billion equity raise with proceeds being used to repay debt in addition to several other credit protection measures to safeguard its credit profile in a much weaker operating environment following the significant rise in interest rates. In addition to the equity raise, Castellum has suspended dividends, reduced capex, and implemented a more conservative financial. We also believe that Castellum will continue to be a net seller of assets through 2024.

Effective leverage decreased from 48% (end-2022) due to a significant equity injection of SEK 10 billion in the beginning of 2023 and stood at 43.7% end-Q3 2023. We expect the company to hover around 42-43% in 2024 and 2025.The debt reduction also caused net debt/EBITDA to decrease significant to 11.5x for the LTM Q3 2023, with an expectation of further improvements to around 10x 2024. EBITDA interest coverage has decreased to 2.6x LTM Q3 2023 from 3.3x in FY 2022 and is expected to recover to around 3.0x by 2025. Castellum is exposed to higher interest rates but has adequate hedges of 61% respectively 45% including fixed debt for 2024-2025 in place.

As a further positive, we note that corporate governance risk has reduced with the stability in senior management as former CEO and board member having resigned at the same time as his shareholding is sold down. Furthermore, we identified an event risk for Castellum related to its significant (33%) stake in Entra ASA (Entra, Baa3 stable), raising the question as to the longer term strategy, risk of conflicts of interest and reduced transparency, which is a credit negative for the company albeit we recognise the monetary value that could provide for alternate liquidity.

RATING OUTLOOK

The stable outlook incorporates our expectation that value, and earnings-based leverage metrics will hover around 42-43% and 10-11x and it reflects that we expect Castellum to conservatively maneuver in a deteriorating financial market environment on the back of higher interest rates and expected yield widening. EBITDA/interest expense is expected to hover around 3x by 2025. The stable outlook also incorporates the expectation that Castellum's business strategy, development and other investment activities remain commensurate with a conservative financial policy supporting its investment grade rating.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE

RATINGS

Factors that could lead to an upgrade

» Effective leverage towards 40%, as measured by Moody's-adjusted gross debt/assets, together with a declining trend from net debt to EBITDA to 10x and financial policies that support the lower leverage

» Fixed charge coverage is above 3.5x on a sustained basis

» Increasing senior unsecured borrowing led to an increase of the pool of unencumbered assets to above 55% whilst at the same time further improves liquidity and the average length of its debt maturity profile

» Reduce reliance on short-term funding and extend debt maturities

Factors that could lead to a downgrade

» There is a deterioration in operating performance or if property market fundamentals weaken sharply

» Effective leverage not maintained well below 50% or if EBITDA fixed-charge coverage is sustainably falling below 2.75x

» Net debt/EBITDA above 13x

» Decreasing senior unsecured borrowing leading to a decrease of the pool of unencumbered assets to significantly below 40%

» Liquidity and access to capital remains sustainably weaken or if large debt maturities in 2024-2025 are not addressed proactively schedule is shortened

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms published in September 2022 and available at https://ratings.moodys.com/rmc-documents/393395. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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