

## **Heimstaden Bostad Q2 2023 Earnings Call**

Christian Fladeland, Chief Investment Officer

Helge Krogsbøl, Chief Executive Officer

Malin Lethenström, Head of Investor Relations

Paul Spina, Chief Asset Manager

Rutger Kaeding, Head of Corporate Finance

Thomas Hansen, Chief Financial Officer

### **Malin Lethenstrom**

Good morning, and thank you for joining us for the presentation of Heimstaden Bostad's financial results for the second quarter of 2023. My name is Malin Lethenström and a head of Investor Relations.

I would like to inform all participants that this presentation is intended for investors and other financial stakeholders only. Today's speakers will go through a management presentation before we open to questions. Questions can be asked on the phone or invite via the webcast by clicking the link in the upper right corner of the screen. And please note that we will only address questions on Heimstaden Bostad.

As always, the Investor Relations team will be available if you have more questions after the session has ended. And with that, I now handover to our CEO, Helge Krogsbøl.

### **Helge Krogsbol**

Thank you, Malin. Good morning. Welcome to our second quarter review for 2023. My name is Helge and I'm here today with our Chief Investment Officer Christian Fladeland, our Chief Financial Officer Thomas Hansen, our Chief Asset Manager Paul Spina as well at Rutger Kaeding who recently joined us as our Head of Corporate Finance.

This is our second quarter presenting in this new format. We appreciate your feedback and actively listen to investor requests to improve our transparency Investor Relations. Today we offer a slightly longer management presentation to highlight key areas of the business before we open both phones and the website for your questions.

In today's presentation, our team will focus on these four themes on slide number three, the fundamentals of residential real estate remain intact. And I am proud to say that we delivered a really strong operational result despite the negative impact on our property values.

Our key operational priority continues to be to deliver durable NOI growth through maintaining high occupancy levels, inflation linked rent increases, and disciplined cost control throughout the business.

Our Q2 results reflect the strength of this focus, an over residential portfolio performed with a like-for-like rental income growth of 5.6% versus 4.8% last quarter.

We also posted an NOI margin improvement of 0.9 points to 66 in Q2 from 65.1 in Q1 on a last 12-month basis. We continue to focus on managing our financial risks by maintaining a strong liquidity position and be at the forefront of any upcoming maturities.

Our asset-backed financing team has closed SEK 15 billion of transactions in the last 12 months, which speaks volumes to our strong bank relationships. As of today we have made good progress to cover funding needs through 2024 and we continue to generate liquidity and turn our intentions to the 2025 maturities.

Finally, our Board of Directors decided to revise the financial policy thresholds and align with S&P's recently adjusted BBB rating thresholds. The new thresholds accommodate the improved operational margins of our portfolio based on durable like-for-like rental growth, the current interest rate environment, and the projected decline in our interest coverage ratio.

Further, the thresholds signal an ambition to defend the S&P BBB rating. The Board of Directors are evaluating potential capital requirements as well as other message that can ensure sustainable compliance herein.

Now, before I hand over to our CFO, Thomas Hansen, I would first like to introduce our new team member who will take over as Head of Corporate Finance. Rutger, the floor is yours.

### **Rutger Kaeding**

Good morning. Welcome from me as well. Replicating my name. I'm a Dutch national and 47 years old. I joined Heimstaden in July this year as the new Head of Corporate Finance, responsible for bank capital markets and treasury activities. I have a long experience in the real estate finance industry, notably the last seven years as Head of Corporate Finance at DIC Asset AG in Frankfurt, a company with around EUR 15 billion assets under management.

Previously I worked for nearly 10 years in real estate investment banking at Barclays. I look very much forward to my time at Heimstaden. As far as I can see, a very professional Pan-European residential platform with a strong portfolio and excellent access to financing. So thank you for your attention. I look very much forward working together. And now I hand over to my colleague, Thomas, for more numbers.

### **Thomas Hansen**

Thank you, Rutger. As mentioned, the Heimstaden Bostad portfolio continues to deliver strong operational results which can be attributed to the disciplined work provided by the operational teams. As Helge stressed, our operational focus has and will be to continue to deliver NOI growth as a key priority.

This requires us to continue to perform with high occupancy levels and deliver on rent increases while generating key cost control measures. I'm proud to say that the intentional measures that we have taken are all contributing to cash flows and reduce the negative valuation effect of yield expansion.

As you can see in this summary, several of our key operational KPIs perform quite strongly and are a continuation of previous trends. We will now spend some time to address each of these KPIs and several of the trends alongside the portfolio splits behind these figures. Real economic occupancy continues to exhibit a strong and stable trend as Heimstaden Bostad sustained a level of 98.1% for the quarter.

Looking at the chart, you can see that the portfolio has delivered consistent results despite the changed macroeconomic environment, which we believe is offset by the supply demand imbalances that continue to shift more in our favor and will continue to support our high occupancy levels.

Some notable countries to highlight on a quarterly basis, the occupancy trend is strong in our regulated markets, including Sweden, which continues to reach high levels with 99% occupancy for the quarter, and we're expecting roughly similar figures for the second half of the year.

Finally, we note that U.K., Finland and Poland constitute 2.8% of the entire portfolio. Their KPIs are impacted by delivery of new assets alongside startup activities as we build our local operations. Like-for-like rental income growth was strong for the quarter as we saw a 5.6% increase over our comparable portfolio.

This excellent performance was above our expectations and is a testament to the hard work and focus from our operational teams. We see the Q2 figure as additional support to our inflation hedge, which over time track above inflation.

Our ambition is to increase rents in accordance with core inflation, all while maintaining a balance to ensure tenant affordability. We firmly believe that nurturing tenant relationships is integral to our friendly homes business model.

Looking at country specifics, we saw strong growth in Sweden of 5.4% like-for-like. This is driven by completed negotiations with local tenant associations as well as value accretive tenant improvements upon churn.

Germany's like-for-like figure of 5.3% was boosted by rent indexations alongside targeted tenant improvement projects and increased occupancy. While the development in Denmark is partly linked to the indexation cap introduced by the Danish government.

And finally, the high growth in the Czech Republic continues where inflation has decreased but remains relatively high compared to the rest of our portfolio. The like-for-like figure of 15.8% corresponds with rent indexation as the underlying market rents have increased. This is further boosted by a high volume of tenant improvement projects as well as a sustainability investment which drive rents in exchange for similar reduction in tenant borne utility cost.

As we've said previously we had expected strong NOI growth and I'm pleased to say that our Q2 result follows this expectation. Looking to the slide, you can see that both NOI measures improved. Specifically, we saw growth to 69% on a quarterly basis and 66% on a last 12-month basis.

This growing margin across the portfolio demonstrates ability to pass on the inflation to an increasingly higher extent. However it is important to note that the seasonality effect that impact different countries in different ways. Looking at the slide, you can see that we've highlighted the contractual heating and water regimes by country for your future reference.

Sweden was a strong performer for the quarter with a quarterly gain of 10.1%. This effect is one off in nature due to seasonality and receipt of a SEK 20 million electricity subsidy. Germany saw decline related to increased vacancy levels which are partially influenced by value accretive tenant improvement projects.

And we note that Poland and U.K. remain in ramp up phase, so margins are not representative of the underlying business. With that, I hand it over to our Chief Asset Management and Development Officer Paul Spina, who will walk through our capital expenditure program.

### **Paul Spina**

Good morning, my name is Paul Spina and I will walk us through our CapEx program across Heimstaden Bostad. First, a brief run through of our definitional framework for capital expenditures, and after I will run through a deeper look through on each section.

All figures and yield references following are on an unlevered basis. We differentiate between CapEx onstanding assets versus development and new production purchased via acquisition. I'll start with CapEx onstanding assets, within which we further segment into our four pillar strategy of maintenance, sustainability, tenant improvements and other value add, all of which with independent thresholds for decision making and reinforcing the optionality of our spending program.

Within this framework, we view spending as either value preserving or value adding. Maintenance CapEx is value preserving for the asset or increases the overall quality of the assets it is spent on. It is always balanced between repair and replacement. I will come back to this in a bit more depth.

Sustainability CapEx supports our company's previously announced climate roadmap in line with science-based targets initiative approved plan and is supporting improving tenant affordability while creating NOI for the investor. Tenant improvements are apartment modernizations carried out only at natural churn and fully refurbished units to a modern, energy efficient, durable unit, capturing rental uplift potential either at market rate or utility value depending on market and local regulations.

Our yield on cost today is on average 8% and decisions are fully optional carried out on a unit by unit basis. Last within CapEx onstanding assets is the value add category and all are fully optional, opportunistic value accretive investments such as building extensions, attic conversions and other income growing projects.

Today our unlevered thresholds are at least 8% and we have in large part drastically reduced new project starts here. From there, we have CapEx on new developments. In this category, we have been on a full investment stop with the last project signed in April of 2022, and today we are simply running off previous acquisitions with spending reducing drastically over the coming quarters.

Forward projects are purchased via turnkey contracts with third party developers who in turn hold all construction risk on the projects. Forward funding projects are funded accordingly to physical construction progress and milestone payments whereby, funding is only spent in accordance with work completed on site.

Forward purchase projects are paid turnkey at completion of the project. Last owned developments are a very small portion of the overall projects, with new builds developed via turnkey contracts on infill land. Given all forward contracts are fully turnkey with no exposure to construction risk.

The only thing left is counterparty risk whereby our turnkey development partners of course have a margin between sales price and construction price and we make a detailed counterparty evaluation and always pursue strong security package by way of external construction performance guarantee providers and relevant parent company guarantees.

Our overall risk to development and construction on forward projects is minimal and well secured. Zooming back out, our overall strategy today is to fully utilize the optionality within our programs and to take decisions on a case by case basis.

First, overall we take fewer new projects postponing opportunistic projects until the future. Second is with a keen eye towards liquidity management. We critically evaluate repair versus replacement for all maintenance spending. And last, our overarching strategy is to optimize for cash flow with a focus towards cash generation projects with immediately positive impacts to the P&L.

Looking at our new build pipeline which is now quickly running off towards completion and transitioning into net operating income for the business, with funding commitments reducing significantly as we look towards 2024 and beyond. Year to date, we have funded SEK 1.5 billion on active projects with a remaining commitment this year of SEK 3.1 billion.

Our pipeline, as mentioned has not grown since April of 2022 and is active in all of our markets. Overall, these projects are estimated to contribute SEK 759 million in additional NOI delivered at an unlevered yield on cost of 4.95%. Where we find it attractive to build for sale, we have planned that from the beginning and this can be seen in the one Norway project listed here on the slide with relatively low implied yield. And of course we hold the option to adjust our plans forward-looking.

Transitioning to look at spend onstanding assets and our capitalized maintenance, the value preservation category, we have reduced spending year-over-year by 15% and forecast full year is SEK 1.5 billion, reflecting roughly SEK 135 per square meter or 0.5% of GAV. Our long term forecast towards stabilization is 0.4% of GAV, assuming values as of today.

Now to look at our overall spend onstanding assets where the spend is stable year-over-year but the distribution and focus has shifted significantly following years of balance sheet growth. Our focus is firmly on top line growth and sustainability with decreased maintenance CapEx based on the high overall quality of our assets.

Our full year forecast for '23 shows tenant improvements to be 0.6% of GAV based on year-over-year growth from the fully integrated Achilles portfolio and strong reversionary rental income potential.

Shown here, our TI program delivers a significant increase in units refurbished per quarter as well as continual quarter over quarter growth of yield on cost. Overall, the cost per square meter have increased

also year-over-year based on increased volumes in both Germany and Sweden with higher relative costs per square meter, but reflected also in the higher rental income per square meter on completed units.

Rental growth per square meter has outpaced the related cost increase significantly, with rental growth per square meter on completed units at 34% versus 20% on cost. Finally is our Climate Roadmap and Sustainability CapEx. In 2021, we initiated our Science Based Targets Initiative approved Climate Roadmap, and this category is comprised entirely of spend to achieve our 42% CO2 reduction target by the year 2030 with 2020 emissions as our baseline.

We're progressing very well in line with our plans and two important call outs hereto. First is that our spending creates yield in two ways dependent on the country where it is spent, either through OpEx reduction in countries where the landlord bears the utility costs, such as Sweden and Finland, or through increased rental income where tenant utility costs are partially offset via increased rental income to fund investments.

What's uniquely important about sustainability CapEx is that despite the landlord's ability to create yield, it in fact supports affordability for our tenants while working towards a carbon neutral future.

Finally, investing in sustainability CapEx ensures our portfolio continues to exhibit high overall quality with continual access to diverse streams of capital via green bonds and sustainability linked financing, improving our refinancing options for years to come. With that, I would like to hand it over to our Chief Investment Officer, Christian Fladeland.

### **Christian Fladeland**

Thank you, Paul. Good morning, everybody. Looking in the past quarter, we have seen that inflation has continued to come down, in particular, headline inflation, while in some of our markets like the U.K. Sweden, it is still coming down at a bit slower pace than we see in continental Europe.

Core inflation still remains sticky and that is also reflected in the interest rate curves which we have seen stabilize now as the monetary conditions have tightened significantly in the past 18 months. When we look at the term structure, it has actually been fairly stable within the last nine months and we also see that reflected in the real rates, which is what we see is dominating the long term underwriting of real estate yields.

We do expect that we will continue to see these tightened monetary conditions well ahead in time. We also believe that the core inflation might also be more sticky than many anticipate. However we also believe that that will tie together with the inflation that will be very supportive of our rental growth going forward.

So how has this fed into our valuations? We have seen a reduction in values across our portfolio of minus 2.1% over the last quarter. There has been a quite big deviation or divergence between the markets in the last quarter, whereas we saw in Q4 last year and Q` this year that there was a much more one directional theme. It's actually three of our markets that is driving most of the value decline in the last quarter being Sweden, Germany and the Netherlands.

Taking Sweden and Germany, it's the regulated markets where we are seeing that the rental growth as a market as a whole is lagging the most. However we also see that we are able to capture very strong rental growth in these markets because we have a lot of value add measures that can be carried out, which is also reflected in the yields that you see here.

I see a lot of market participants focusing on very low yields compared to official yield series. It's very important to realize that all yield series that are published by brokers, et cetera, reflect stabilized yields. We get external valuations on all our assets, reflecting the red reversion potential and the value add potential that we have. And in Germany and Sweden, this is particularly large given the type of assets that we have.

In the Netherlands, we continue to see a decline of almost 3%, which corresponds well with previous quarters and that is very much driven by a homeownership market which is still showing signs of weakness. Interesting, we have actually seen in the last quarter that prices have stabilized, but we also see that values are factoring in that there might be continued pressure going ahead and that is reflected in their cash flow valuations.

In the remaining six markets, we actually saw that values were essentially stable ranges between minus 1% and plus 1% reflecting that yields have started to level off or the yield increase have started to level off and the rental growth is offsetting the negative impact from the yield increases.

When we take into account the CapEx and the new builds that we have taken over in the quarter, there has been an addition to our GAV of around SEK 2 billion and then we have had a smaller divestment completed in the quarter. Divestments is something that we have been doing continuously on some noncore parts of our portfolio. In particular, where we have Swiss cheese assets that are obvious for privatizations.

Given how we look at the forward-looking returns and the actually quite strong owner occupier market that we see across several of our markets, we believe that the divestments related to privatization will increase in the coming quarters.

When we look at the alternative cost of capital and the fact that we are able to divest at significant premiums to book value, we don't believe that the forward-looking returns necessarily is attractive to keep this on our own balance sheet and it has a much higher value for us by deleveraging our balance sheet and using it to fund our future maturities.

There has been a significant depreciation of the SEK against all our other currencies in the last quarter and that has reflected in a positive FX effect of almost SEK 10 billion during the quarter. Summarizing our debt portfolio as of the end of Q2 '23, we had a debt of portfolio of SEK 193.7 billion. The main driver of the change here has been FX impacts as we fund our foreign investments in local currencies in general, so that has increased the debt measured in SEK.

In addition, we have taken on SEK 3 billion in additional asset-backed funding as part of our plan to shift more of our funding sources to secured bank debt in order to fund our upcoming bond maturities. This translate into SEK 15 billion taking out in year to date 2023. And if we include 2022, it means that we've taken out SEK 40 billion in asset-backed funding over the past 18 months.

We will continue to take out asset-backed funding and we see that we have good access to it. It's important to realize that even though we are a Swedish company, we are very diversified in terms of portfolio. That also means that we have a diversified number of bank markets to actually access and we don't see that we have any restrictions in getting asset-backed funding when we look at the individual size portfolio in each market subject to the regulatory restrictions that there might be on individual bank exposure towards one client. That's a very important characteristics of our portfolio.

Our funding costs continue to take up as our interest rate fixings are expiring and that we are resetting at higher levels. It has gone up from 2.2% to 2.5% in Q2 '23 and that we should expect to continue to take up in the coming quarters as our interest rate hedges lapse and we need to reset at higher levels.

As was the case in Q1 this year, we still see that secure funding is comprising the majority of our debt portfolio, opposite what we have seen throughout 2022. The increase in secured debt proportion will only increase in the next six months as we finalize the asset-backed funding pipeline that we have that will ensure that we have full control of all our maturities in the bond market, including the whole of 2024.

We still maintain BBB flat ratings with both Fitch and S&P with a negative outlook on both. Looking at the upcoming maturities, we have only a moderate number of maturities coming in the rest of 2023. We have a EUR 450 million bond expiring here in September, whereof we have acquired back around 100 million. So it's EUR 350 million outstanding. All that is of course covered by the cash balance that you see on our current balance sheet, as well as a significant amount of secured facilities.

Looking into 2024, we have two larger maturities. We have a EUR 700 million maturity in Q1 '24, of which we have already bought back EUR 200 million in earlier tender offers. So 500 million outstanding and then we have 1.2 billion out of the EUR 1.25 billion euro issuance expiring in October 2024.

These will be covered by the asset-backed funding pipeline that we will complete within the next quarter and then we will have 2024 fully in control. After that, we will look into 2025 and start to make measures in order to make sure that we can get those funded also in the asset-backed funding market, assuming that the bond market might be closed for longer.

Our financial policy. We mentioned in the Q1 reporting that we were to do a review of the financial policy which was reflecting another interest rate environment that we are seeing today. Back in April 2021, we made our more tightened financial policy reflecting the low interest rate environment whereby we said that our interest coverage ratio per the S&P definition should exceed 2.4.

We also had a net debt to net debt plus equity per the S&P method threshold of 55%. We mentioned last time that we would reduce thresholds to reflect the current market environment that we're navigating with higher rates but also higher rental growth that is supporting a lower EBITDA -- sorry, a lower ICR threshold.

We have decided to amend the financial policy to the S&P defined BBB flat threshold as of last December 2022, i.e. that we should maintain our interest current ratio above 1.8 and that the net debt to net debt plus equity may not exceed 60%.

Please note that if you were very quick at downloading our quarterly report 08:00 this morning, there was a typo where it was stated that our net debt to net debt plus equity should still be maintained below

55% and the 60% had, by a mistake, gone down to the interest rate hedge ratio. That was a typo. A new one was uploaded at around 9:40 this morning.

So the interest rate hedge ratio remains at above 75%. It's the net debt to net debt plus equity that has been increased to 60%. Be rest assured 60% that having increased this net debt to net debt plus equity to 60% doesn't reflect any intention of increasing the leverage of the company. We have a clear target to continue to reduce the leverage of the company, which is also reflected in the more tightened ICR ratio, which most certainly would require deleveraging in order to fulfill the 1.8.

The board has communicated through the press release and through the quarterly report that we are focused on taking the necessary measures in order to make sure that we comply with this ICR threshold on a stabilized and sustainable basis. There are several measures that can be taken, but disposals as well as new capital injections are of course some of the most obvious and impactful ones.

We are doing divestments, as mentioned earlier, but still in a very moderate scale and we are looking into how we can increase that while still preserving good and strong shareholder value. We see significant potential to continue to increase our privatization program and also see that that will be able to free up significant capital over a two to three year period when we look at the churn in some of these markets where we enjoy significant premiums to book values.

Looking at the Netherlands, for example, we are divesting at around 40% gross margins compared to our book values. In Denmark, we believe we would be able to capture 15% to 20% in Germany also plus 40%. So while a detailed plan of this is still under evaluation, it is very much likely that we will continue to increase that pace in the coming quarters and we will of course report here on as we have quantified how much we target to sell through these privatization schemes. With that being said, I hand over to the Q&A.