Research Update:

Belgium-Headquartered Aedifica N.V./S.A. Assigned 'BBB' Rating; Outlook Stable

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PRIMARY CREDIT ANALYST

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Rating Action Overview

- Aedifica N.V./S.A. (Aedifica) manages a portfolio of about €4.4 billion of health care properties as of June 30, 2021, mainly care homes and senior housing for elderly people, spread across seven European countries.
- We expect demand for Aedifica's properties to remain high in the coming years, thanks to positive underlying demographic trends, such as aging populations.
- We assigned our 'BBB' long-term issuer credit rating to Aedifica.
- The stable outlook reflects our anticipation that Aedifica's portfolio should continue to generate stable and predictable cash flows over next few years, with debt to debt plus equity at about 45% and solid interest coverage above 5x.

Rating Action Rationale

We anticipate market fundamentals to remain strong for Aedifica's properties and we expect predictable and positive like for like (LFL) rental income growth for the company in the next few years. Our rating on Aedifica is supported by the company's resilient and geographically well diversified property portfolio within elderly care homes (68% of property value as of June 30, 2021), as well as the company's mix of elderly care buildings (15%) and senior housing (5%), where demand should remain strong and new supply should moderate in the next few years. The portfolio stood at €4.4 billion, comprising 543 properties, as of June 30, 2021. We understand Aedifica fully leases out its premises to operators on a long-term basis, which provides high cash flow visibility and predictability. The company has a relatively modern asset base: Almost 70% of its assets are less than 10 years old, so we think maintenance costs remain limited.

The portfolio is spread across seven countries in Europe. The majority are in Belgium (28% of portfolio value), Germany (21%), Finland (18%), U.K. (17%), Netherlands (13%), and Sweden (just under 1%). Following acquisitions in early 2021, the company also operates in Ireland (1%), which we view as having strong publicly funded welfare systems. That said, we note the potential political risks related to reimbursement and changes in the regulatory environment. Operators in

Sweden and Finland are mainly funded via public health care spending whereas operators elsewhere in Europe are mainly funded by government health care insurance and fees from users. However, we do not expect any political or regulatory risk to harm Aedifica's operational performance in the short to medium term. We anticipate demand for Aedifica's assets will remain solid in the regions where the company operates, underpinned by demographic changes, such as a rapidly growing share of elderly people, and subsequent higher needs for nursing homes and health care assets.

Our rating takes into account the company's high occupancy rate of close to 100% with very long lease durations, averaging 20 years. Accordingly, we anticipate stable and predictable cash flows over the coming 12-24 months. We forecast LFL rental income will grow by up to 1% since most lease agreements are linked to inflation.

Aedifica has shown resilience during the COVID-19 pandemic, despite challenges for its tenant base. Aedifica's business has shown limited damage from the pandemic. In the wake of a difficult macroeconomic environment in 2020, the portfolio reported positive LFL rental growth of 0.9% while retaining rent collection at pre-pandemic levels. Asset values have also remained broadly stable. We view health care properties as lower risk by nature, especially housing for elderly people, since demand is less sensitive to economic cycles than in other sectors, such as retail or offices.

We also note some barriers to entry in Aedifica's markets, such as the importance of relationship with municipal governments. In addition, we view moderate risk for oversupply because the segment will expand and outsourcing opportunities will arise following further privatization in some of Aedifica's regions of operation, such as the Nordics, where assets are mostly owned by the municipalities. Some operators have experienced difficulties during the last 12-18 months, following social distancing measures and high death rates in elderly care homes due to the pandemic. Aedifica has some tenant concentration, with Korian being its largest tenant (12% of Aedifica's assets), followed by Colisee (8%) and Orpea (6%). That said, we understand several lease agreements partly mitigate the concentration on its largest tenants. We understand most of Aedifica's tenants have not experienced any payment difficulties during the pandemic.

We expect Aedifica to continue expanding its portfolio strongly in the next 12-24 months, in line with its growth strategy. Aedifica has continued growing its portfolio in the past 24 months to €4.4 billion as of June 30, 2021, from €2.3 billion as of June 30, 2019, mainly following the acquisition of Finnish real estate player Hoivatilat, as well as several projects across Belgium, Germany, and the Netherlands. In the first half of 2021, the company announced further acquisitions of about €664 million and, combined with the current pipeline of investments, we expect the portfolio will grow to almost €5 billion by year-end 2022. About two-thirds of its pipeline is located in Germany, where we anticipate its overall exposure to increase in future years. We think the company will use a balanced mix of debt and equity to fund its growth. Aedifica has a good track record of issuing equity to support acquisitions over recent years.

We expect Aedifica's leverage ratios will remain at current levels and in line with its financial policy. Our assessment of Aedifica's financial risk profile is based on the company's strong EBITDA interest coverage ratio of above 5x, based on a very low cost of debt at 1.5%, as well as its debt-to-debt plus equity ratio of about 45%-46%. We forecast the company's ratio will remain at similar levels for the next 12-18 months. This would be also in line with its financial policy of net debt to total assets no higher than 50%. Our assessment also takes into account the company's debt to EBITDA of 11x-12x. The recent increase from 8.6x as of June 30, 2019, follows the company's intensive investment pipeline. We expect the ratio to stabilize below 11x from 2023, assuming a significantly lower investment volume than in 2021 and 2022. The company's capital structure is largely unsecured and has a weighted average debt maturity profile of 4.4 years.

Our rating incorporates a one-notch downward adjustment for our comparable rating analysis, reflecting Aedifica's smaller and therefore more concentrated asset base compared with higher-rated peers. Compared with higher rated peers with similar capital structures and credit metrics, such as German residential real estate landlord Grand City Properties or French retail landlord Klepierre S.A., Aedifica's portfolio is significantly smaller and has a more concentrated asset and tenant base. This is also reflected in the company's overall limited absolute cash flow generation. In addition, we note the company's intensive investment pipeline--including development projects and acquisitions--of more than €1 billion targeted until the end of 2022, which will continue to weigh negatively on our ratio of debt to EBITDA over the forecast horizon.

Outlook

The stable outlook reflects our view that the company's predictable rental income, supported in particular by its resilient health care assets and overall long leases (20 years), should enable it to continue generating stable cash flows over the next 24 months. We also expect the company to maintain S&P Global Ratings-adjusted debt to debt plus equity below 50% by funding its future investments with a balanced mix of debt and equity, in line with its financial policy.

Downside scenario

We could lower the rating on Aedifica if:

- Adjusted debt to debt plus equity increases above 50%, which could occur if Aedifica funds its external growth purely with debt, or in case of material portfolio devaluation;
- Annualized debt to EBITDA rises materially above 13x;
- Rental income declines materially, due to lower occupancy levels, for example, leading to adjusted EBITDA interest coverage falling below 2.4x; or
- Liquidity would deteriorate, for example, due to a high committed investment pipeline not sufficiently backed by available undrawn credit lines or a substantially higher usage of short-term debt, such as commercial paper (CP).

Upside scenario

We could raise the rating on Aedifica if:

- Adjusted debt to debt plus equity improves toward 40% or less on a sustainable basis, as a result of a change in Aedifica's financial policy;
- The company's debt to EBITDA declines toward 9.5x;
- EBITDA interest coverage remains at current levels; or
- Aedifica were to significantly expand its portfolio scale and scope so that it becomes more aligned with that of peers in a higher rating category.

Company Description

Established in 2005, Aedifica is a listed Belgian company that specializes in health care properties, with a particular focus on housing for elderly people with care needs. Aedifica is headquartered in Belgium and has been listed on Euronext Brussels since 2006.

The company has a portfolio value of about €4.4 billion as of June 30, 2021, comprising 543 properties. It portfolio generates annual contractual rent of €236 million with a gross yield of 5.6%.

Aedifica operates under the REIT regime. The company's largest shareholder is BlackRock with 5.0% as of August 2021. The free float is 95%.

Our Base-Case Scenario

- Rental growth of up to 1% because we assume rents will grow in line with inflation in the company's regions of operations. We base our assumptions on our forecasts of consumer price index growth of about 1.5%-2.0% in Belgium, the Netherlands, and Germany for 2021 and 2022.
- A sustained high occupancy rate close to 100% in the next 24 months, thanks to Aedifica's long lease contracts.
- Overall stable EBITDA margin at 82%-83%, given most of the leases are triple- and double-net leases.
- Capital expenditure of approximately €200 million-€300 million per year in 2021 and 2022, including purchase of development projects. In addition, we forecast portfolio acquisitions of about €550 million and about €100 million in 2021 and 2022, respectively.
- We assume 0%-1% positive portfolio revaluation in 2021-2022, supported by low indexation and conservative assumptions on yield developments.
- Dividend payments of about €55 million-€60 million in 2021-2022, in line with the company's policy and the minimum payout ratio of 80% of the adjusted statutory results.
- Average cost of debt to remain stable at close to 1.5%.

Key metrics

Based on these assumptions, we arrive at the following credit measures over the next 12-18 months:

- EBITDA to interest coverage of about 5.2x;
- Adjusted debt to debt plus equity at about 45%-46%; and
- Debt to EBITDA of close to 11.5x.

Liquidity

We assess Aedifica's liquidity as adequate, based on our estimate that the company's liquidity sources will likely cover uses by more than 1.2x in the 12 months starting June 30, 2021, mainly supported by an available undrawn credit line of over €700 million and a committed bridge facility of €150 million.

Principal liquidity sources as of June 30, 2021, include:

- €23.0 million in available unrestricted cash;
- Undrawn committed credit lines of about €813 million with a maturity of more than 12 months;
- Our forecast of cash funds from operations of around €140 million-€150 million; and
- A committed bridge facility of €150 million, maturing in 2023.

Principal liquidity uses include:

- €356 million of short-term debt maturities, including €301 million of CP;
- Cash dividends of about €55 million-€60 million; and
- A committed investment pipeline of about €450 million for the next 12 months.

Covenants

Compliance expectations

Aedifica has covenants under its outstanding bank debt and credit lines. We understand that the headroom under these covenants is adequate, at more than 10%. We expect Aedifica to maintain sufficient headroom under all outstanding and future financial covenants.

Requirements

Main financial bank covenants for Aedifica:

- Net debt to total assets of max 60% (42.0% as of June 30, 2021).
- Interest coverage ratio above 2.0x (5.4x as of June 30, 2021).

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/--

Business risk: Strong

- Country risk: 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)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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	
Aedifica N.V./S.A.	
Issuer Credit Rating	BBB/Stable/--

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 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/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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

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