NCR comments on EPRA LTV guidelines

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On 21 Mar. 2022, the European Public Real Estate Association (EPRA) announced the introduction of a new financial metric, the EPRA loan-to-value (LTV) ratio, which is to be included in the association's recommended best practices. Real estate companies which adopt the guidelines must comply with the recommendations or explain why they do not. Two key aspects of the recommendations relate to EPRA's treatment of hybrid instruments and its treatment of assets and liabilities in joint ventures (JVs) and associated companies.

TREATMENT OF HYBRID INSTRUMENTS

NCR takes a positive view of EPRA's attempts to increase comparability across the real estate sector. We understand that the association's guidelines are based on a shareholder's perspective and believe that its debt treatment of all hybrid instruments (except for D-shares, which are viewed as equity) is adequate in this context. From a credit perspective, we argue that the relative subordination of hybrid instruments (such as preferred shares and hybrid bonds) in comparison with senior debt is adequately reflected by attributing some equity treatment to such instruments. This reflects the potential to absorb losses via deferred coupon and principal payments, the possibility of exchanging hybrid bonds and/or preferred shares for common equity (even in distressed exchanges), and the subordination of hybrids to senior debt in the event of liquidation.

We do not expect to make any changes to our calculations on the basis of EPRA's guidelines. In our credit metrics for real estate companies, we generally view D-shares as 100% equity while hybrid bonds are given either 0% or 50% equity treatment depending on the permanence of the instrument. Preferred shares are given 0–100% equity treatment, with 50% being the most frequent option (see our previous comments on corporate hybrids and preferred shares here).

Figure 1. NCR's equity treatment of hybrid instruments

	Hybrid bonds	Preferred shares	D-shares
Equity treatment	0–50%	0–100%	100%

Due to the extensive use of hybrid instruments by some Nordic real estate companies, the treatment of such instruments can have a substantial impact on their financial metrics. Among NCR-rated issuers, only Stendörren, Svenska Handelsfastigheter and NP3 (see Figure 2) have outstanding hybrid instruments. We treat Stendörren's sole hybrid bond as 100% debt in our calculations due to the instrument's lack of permanence. Svenska Handelsfastigheter's preferred shares are treated as 100% equity due to, among other factors, the long-term commitment of the institutional owners which hold these shares. If Svenska Handelsfastigheter's preferred shares were treated as 100% debt in line with EPRA's calculations, the company's NCR-adjusted net LTV would increase to roughly 80% from 53.7% (as of end-2021), a level which we do not see as adequately reflective of the company's financial risk. If NP3's preferred shares were treated as 100% debt, compared with our current 50% treatment, the company's NCR-adjusted net LTV would increase to 65.0% from 61.7% (as of end-2021). In our view, the financial risk profiles of the issuers we cover are adequately captured by their current NCR-adjusted metrics.

TREATMENT OF ASSETS AND LIABILITES IN JOINT VENTURES

In EPRA's LTV calculation, the association includes a company's proportionate consolidated share of assets and liabilities in equity-accounted investments, such as JVs and associated companies. JVs and associates have been used increasingly in the Nordic real estate sector over the past few years, which has reduced transparency and increased complexity in the sector. For this reason, we welcome the increase in transparency that EPRA recommends.

While we believe that EPRA's approach to JV and associated company assets and liabilities is essentially sound, we take the view that the extent of an issuer's exposure to such assets and liabilities is not always easy to determine due to lack of disclosure. Although we acknowledge the desirability of including a parent company's share of such assets and liabilities, we plan to continue assessing the feasibility of including them in our calculation of credit metrics. We expect no direct impact on our ratings, because most NCR-rated issuers have limited exposure to such investments. Where relevant, we have considered a parent company's exposure to debt in JVs and associated companies in our financial risk appetite assessment rather than our financial ratio analysis and we take the view that such risk is already reflected in our current issuer ratings.

NCR-RATED PROPERTY MANAGERS

Figure 2. NCR's ratings on Swedish property managers

Issuer	Primary property type(s)	Long-term issuer rating	Outlook
Axfast AB (publ)	Offices	BBB	Stable
Bonnier Fastigheter AB	Offices	BBB	Stable
CA Fastigheter AB	Residential	BBB-	Stable
Catena AB (publ)	Logistics	BBB-	Stable
Fastighets AB Stenvalvet (publ)	Community service	BBB+	Stable
Heba Fastighets AB (publ)	Residential	BBB+	Stable
Intea Fastigheter AB (publ)	Community service	BBB+	Stable
LSTH Svenska Handelsfastigheter AB (publ)	Retail	BBB-	Stable
NP3 Fastighets AB (publ)	Industrial/warehousing	BB	Stable
Platzer Fastighet Holding AB (publ)	Offices	BBB-	Stable
Stendörren Fastigheter AB (publ)	Industrial/warehousing	BB-	Stable
Stenhus Fastigheter i Norden AB (publ)	Retail/industrial	BB	Stable
Studentbostäder i Norden AB (publ)	Residential	BB-	Stable
Svensk FastighetsFinansiering AB (publ)	Offices	BBB+	Stable
Vacse AB (publ)	Community service	A-	Stable

See NCR's company reports for details.

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