

# Financial policy and benchmarking

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## Purpose

The purpose of this essay is to perform a benchmark analysis of Akelius' financial policy and to compare the results to other Swedish real estate companies.

## Method

The selection of peers has been done randomly and dependent upon what information is available on their homepages or annual reports. The information about their financial policy is collected from each company's respective homepage or year-end reports.

In Appendix 1 there is a short description of each company.

## The Financial Policy

The financial policy stipulates the firm's choice, and acts a guideline, regarding the mix of debt and equity, the maturity of debt structure, the interest rate risk, the markets in which capital is raised, hedging decisions and the firm's financial risk. The financial policy also normally defines the roles and responsibilities for every person in the organisation who has some role in financial management.

The policy should be communicated to the owners, the management and to other stakeholders. It provides management with a tool to limit or avoid risk. The financial policy can be the basis of a corporations risk management framework and it should include policies and procedures that management and auditors can review occasionally.

The business environment can change quickly but policies are reviewed rarely. The result can be a policy disconnected from day-to-day operations that places unnecessary and inappropriate restriction on the business. It is therefore important to develop an internal reporting and control system to ensure that the policy is followed. By monitoring and following up the financial policy, management will be given the opportunity to re-act in time and to change the policy when necessary.

## Financial policy as a risk management tool

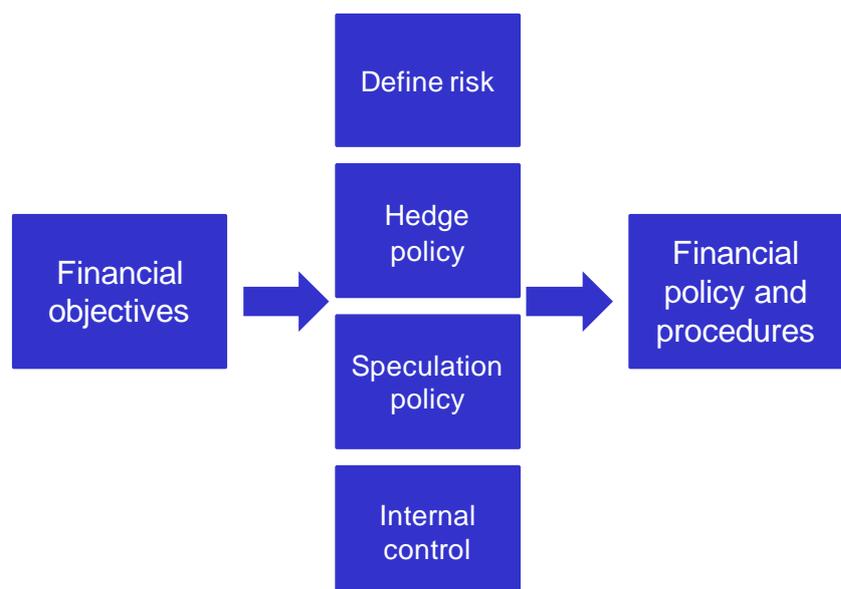
The financial policy should stipulate the firm's financial objectives and thereby take the financial risk into consideration.

When creating a financial policy the following questions should be answered:

- What are the financial goals and objectives of the company?
- How do the financial objectives connect to risk?
- How are hedging decisions made?
- How is the performance of the portfolio and its various components measured?
- What is the role of speculation in the company?

Clear and measurable financial objectives should be determined and their implication of risk should be analysed. The risk tolerance level of the firm should be stated in the financial policy. The hedging strategy should be defined so that it is not based on a market "feel". A hedging strategy is not very effective if a hedge is used only sporadically. The policy should include how much and on what terms the firm should hedge and what financial instruments are accepted.

How the internal control and reporting should be organized should also be stated in the financial policy.



**Picture 1: Framework financial policy**

## **Akelius' financial policy**

The financial policy states that, The Loan to value (LTV) of mortgage loans shall not exceed 60 percent and the LTV of the whole debt portfolio shall not exceed 70 percent. Akelius' sources of funding today are mortgage loans, unsecured promissory notes and equity. End of December 2010 our property portfolio is only leveraged with an LTV of 63 percent.

The Financial policy of Akelius' clarifies the role, authorities, and responsibilities for essential financial management activities and decisions within the Akelius Fastigheter Group AB. The financial policy stipulates the guidelines for capital structure and it regulates the risk management.

The financial policy regulates the following areas:

- Refinancing risk
- Interest rate risk
- Liquidity risk
- Currency risk.

## **Delegations of Responsibility**

### **Board of Directors**

The Board of Directors determines and approves the financial policy. The Board of Directors is responsible to outline the framework of the financial activities within Akelius Fastigheter Group AB. The Board of Directors:

- Determine and approve the Financial Policy
- Make strategic decisions
- Authorise financial contracts and derivative transactions with a financial value over SEK 1,000 million

### **Financial committee**

The Financial committee accounts for decisions, in respect to loans and derivative transactions with a financial value below SEK 1,000 million. The committee has a meeting at least once every quarter and the members are the Chairman of the Board of Directors, the Chief Executive Officer, the Chief Financial Officer and the Treasurer.

## **Chief Executive Officer**

The Chief Executive Officer (CEO) is responsible for organising the finance activity of Akelius Fastigheter AB and will thereby make sure that the Financial Policy is followed. The CEO accounts for decisions in respect to loans and derivative transactions with a financial value below SEK 500 million.

## **Finance Department**

The objectives of the finance department at Akelius Fastigheter AB are to secure a positive cash-flow and to minimise risks. This means minimizing the interest costs, foreign exchange, liquidity and refinancing risk. To reach these goals, restructuring of loans, derivatives and securities have to be made continuously.

The Financial policy outlines the framework for the financial department and works as a guideline for the financial manager in its daily work.

## **Financial Risk**

### **Refinancing risk**

To reduce the refinancing risk, i.e. the risk that Akelius Fastigheter AB, at any time, may not be able to refinance existing loans on reasonable terms, Akelius is working with 14 different banks and also receive funding from the parent company.

### **Long term Capital hedge**

The financial policy states that Akelius should have a long term capital hedge. The finance department therefore continuously monitors the debt portfolio and makes changes to optimise the interest hedge and capital hedge. Maturities of the loans and credit agreements are prolonged before they go too short.

The refinancing risk is limited through long term, up to 20 years, credit agreements. Short term financing, i.e. maturity within one year, must not exceed 20 percent of the whole portfolio of mortgage loans.

### **Liquidity**

Akelius' liquidity is secured via long-term credit agreements that have been closed with three major banks. In order to meet short term liquidity changes, revolving credit lines are used.

With a revolving credit line, money can be drawn when needed and thereby the cash management is optimised.

To reduce risk and variations in cash flow, Akelius works with long term interest hedges. The interest rate hedge is managed through fixed interest rate loans and interest rate swaps. At the end of December 2011, the average maturity of the interest hedges was 5.8 years and 69 percent of the mortgage loans have an interest hedge for five years or longer.

The Financial Policy also regulates the investment of surplus liquidity in terms of counterparty, instruments and time-frame.

## Benchmarking

In all selected companies, the financial policy is determined and approved by the Board of Directors. The financial policy also outlines the responsibility of everyone participating in the financing activities.

### Capital structure

The proportion of equity is impacted by the chosen level of financial risk and lender's equity requirement in order to provide market based financing.

Some companies have communicated a goal for their equity ratio level and others do not communicate this to the market.

Table 1 shows the outcome of equity ratio and also if the firm has communicated any goal.

#### Equity ratio

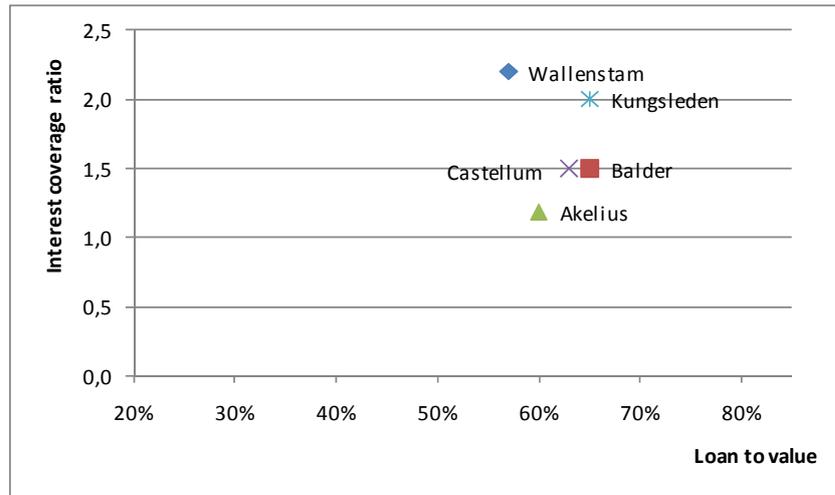
	Goal	Outcome
Akelius		26%
Wallenstam	>25%	37%
Balder	30%	31%
Castellum		35%
Kungsleden		30%

Table 1: Comparison equity ratio

Akelius' financial policy stated that the LTV of mortgage loans shall not exceed 60 percent. This LTV figure is quite low compared with other firms focusing only on residential properties. Normally, the bank accepts a maximum LTV of 80 percent but other peers in the real estate business have a LTV between 55-65 percent.

The LTV ratio is also dependent on what type of property the company holds. Firms with commercial properties have a lower

LTV as otherwise they may not be able to receive market based financing from banks.



Picture 2: Comparison interest coverage ratio and LTV-ratio

Akelius has a lower coverage ratio than other real estate companies in the business. However, Akelius received funding from unsecured loans. Unsecured loans can be classified as equity and seen as risk capital. If we calculate the ICR on only mortgage loans, the ICR of Akelius improves.

### Capital hedges

Akelius should have a long term capital hedge, and at the end of December 2010 the average maturity for capital hedges was 5 years. Kungsteden has as a financial strategy for achieving a long term capital hedge and thereby reduce the re-financing risk. Castellum works with revolving loans, utilized during long-term credit agreements.

#### Capital hedges, years

	Outcome
Akelius	5,00
Wallenstam	2,33
Balder	5,90
Castellum	5,00

Table 2: Capital hedges end of December 2010

### Liquidity

Wallenstams liquidity should at all times be at least the net payments including interest and amortisations. Akelius goal is to have a liquidity at all times of at least SEK 750 million. The liquidity of Balder amounted to SEK 507 million the 31<sup>st</sup> of December 2010.

## **Appendix 1 – Short description of each company**

### **Kungsleden**

Kungsleden is a listed Swedish property company. As of the 31<sup>st</sup> December 2010 they had 592 properties with a book value of SEK 21.5 billion. Kungsleden has properties in 133 municipalities in Sweden. The portfolio consists of commercial properties, public properties and modular buildings and has a book value of SEK 22 billion at the end of December 2010. Rental income amounted to SEK 2,304 million.

### **Fastighets Balder AB**

Fastighets Balder AB is a listed on Nasdaq OMX Stockholm, Mid Cap company and their real estate portfolio had a value of SEK14.4 billion at the end of December 2010. Rental income amounted to SEK 1,333 million.

### **Wallenstam**

Wallenstam property portfolio is focused on residential and commercial properties in Gothenburg. Approximately 60 per cent of the property value is represented by residential properties and the market value of properties amount to approximately SEK 22 billion. Wallenstam's B shares are quoted on the Mid-Cap list of the Nasdaq OMX Stockholm

### **Castellum**

Castellum owns and manages commercial properties in Greater Gothenburg, Öresund Region, Greater Stockholm, Mälardalen and Eastern Götaland. The market value of the property portfolio amount to approximately SEK 32 billion  
Castellum is a listed company and the share is registered on NASDAQ OMX Stockholm AB Large Cap.

## References

Fastighets AB Balder's homepage  
<http://www.balder.se/start.aspx>

Wallenstam AB's homepage  
<http://www.wallenstam.se/>

Casetlumms's homepage  
<http://www.castellum.se/>

Kungsledens' homepage  
<http://www.kungsleden.se/>