Credit Rating Announcement

09 December 2022

Scope affirms BBB rating of Samhällsbyggnadsbolaget i Norden AB changes Outlook to Stable

The Outlook change to Stable from Negative reflects an expected improvement in credit metrics following the spin-off of an education portfolio into a joint venture

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope Ratings GmbH (Scope) has today affirmed the BBB issuer rating of Samhällsbyggnadsbolaget i Norden AB (SBB) and revised the Outlook to Stable from Negative. Scope has also affirmed the BBB senior unsecured debt rating, BB+ subordinated (hybrid) debt rating and S-2 short-term debt rating.

Rating rationale

The Outlook change follows the announcement that SBB i Norden will place SEK 44.9bn of educational properties (EPP) into a joint venture with Brookfield. SBB retains a majority share of 51%, provides debt financing and fully controls and consolidates the joint venture, while Brookfield pays a cash consideration of SEK 9.2bn plus a potential earn-out of SEK 1.2bn for 49% of the equity in the newly formed EduCo. This transaction, in addition to the spin-off of the Amasten residential portfolio (SEK 18bn), reduces SBB's leverage as measured by its Scope-adjusted loan/value (LTV) ratio to slightly under 50% and boosts interest coverage to above 2.2x as cash proceeds are expected to be used for repaying a bridge loan and upcoming maturities, thus deleveraging.

SBB's business risk profile (assessed at BBB+) is only marginally impacted by the planned spin-off of an SEK 18bn residential portfolio into a separate entity, which should be accepted at the upcoming extraordinary shareholder meeting on 21 December 2022. The disposal of 49% of its to-be-created EPP joint venture does not impair the assessment. The educational disposal will remain fully consolidated and controlled by SBB and contributes in full to the company's business risk profile. The residential spin-off reduces Scope-adjusted assets by around 10%, contributing to a slightly more balanced geographic diversification (Sweden now represents only 73% of rental income from 76%) and increases profitability as the EBITDA margin of community services properties lies above that of residential.

Scope sees SBB's initiatives within resource management and product innovation, as well as its activities on the social front that reduce regulatory and reputational risks, as a further strength for its asset quality (ESG factor: credit positive).

SBB's financial risk profile (assessed at BBB-) benefits from the successfully executed tender to repurchase hybrids and unsecured bonds at a discount; the signed and announced EPP joint venture with Brookfield as a 49% shareholder; the intended spin-off of the residential portfolio (SEK 18bn; ex-Amasten); and the subsequent distribution of shares to SBB shareholders.

SBB achieved SEK 1.4bn of repurchasing gains through the November 2022 tender to buy back hybrids and bonds outstanding below par and executed disposal gains in Q4 2022, in addition to the net cash effect of the residential portfolio spin-off (assumed at SEK 1.5bn) into Q4 2022, bringing down its LTV ratio. Scope's view of a 2% negative fair value adjustment on the non-transaction portfolio in Q4 2022 counteracts these efforts, taking Scope-adjusted LTV to 53% at YE 2022 compared to 54% at Q3 2022. The net cash proceeds from the disposal of 49% of the EPP joint venture (SEK 9.2bn) and the subsequent repayment of the bridge loan (SEK 7.1bn) in H1 2023 will reduce LTV to 49% at YE 2023. This is despite Scope's expectation of a yield widening in 2023 and 2024, counterbalanced by strong CPI pass-through in full on the community property side, while assuming partial pass-through on residentials (to a lesser degree and with a lag). In the absence of significant further deleveraging in the base case, LTV remains around 2023 levels. Scope expects leverage as measured by the Scope-adjusted debt/EBITDA ratio to decrease from around 20x to around 18x by 2024.

SBB's Scope-adjusted EBITDA interest cover was above 3x for the last three years and currently stands at 3.5x (last 12 months to end-September 2022). The company's average funding rate increased significantly throughout 2022, with the latest reading at 1.89%, up from 1.11% at YE 2021 reflecting a more challenging funding situation for the sector. However, the increased hedging ratio of 80% as at end-September 2022, benefits the stability of the company's interest cover in the medium term. Nevertheless, reflecting all the Q4 2022 changes, Scope expects an interest cover of 3.0x for 2022, decreasing to 2.4x in 2023 and stabilising at that level thanks to EBITDA growth and deleveraging compensating for assumed higher refinancing costs.

Liquidity is adequate as expected cash sources cover uses by about 2x as of YE 2022. The company benefits from a large multi-year credit facility (SEK 16bn undrawn), significant cash proceeds from transactions to repay upcoming maturities, a low secured LTV ratio of 19% as of Q3 2022 and well-spread maturities. The company has good access to capital markets and secured lending. The low secured LTV ratio and ample unencumbered assets provide sufficient headroom to refinance short-term debt.

One or more key drivers of the credit rating action are considered ESG factors.

Outlook and rating-change drivers

The Outlook for SBB is Stable and reflects Scope's view that the EPP joint venture and the residential spin-off should lead to deleveraging sufficient to decrease LTV to around 50% while interest cover deteriorates less than previously anticipated and remains comfortably above 2.2x. The outcome of the deleveraging depends on the resilience of SBB's asset value in a widening yield environment.

A negative rating action could occur if the Scope-adjusted LTV ratio moved above 55% or interest coverage moved below 2.2x on a sustained basis, such as through significant, predominantly debt-funded acquisitions or a severe reduction in the fair value of properties compared to Scope's base case. The latter could be driven by higher-than-anticipated funding costs and less debt repayments.

A positive rating action would require the Scope-adjusted LTV ratio to remain significantly below 50% on a sustained basis, with interest coverage remaining close to 3x. This could be driven by a lower proportion of debt-funded capex, decreased refinancing needs through stronger-than-anticipated portfolio cash flows, a strong improvement in market sentiment resulting in fair value appreciations, or a change in the funding mix.

Long-term and short-term debt ratings

As of 30 November 2022, SBB had SEK 51bn in senior unsecured debt outstanding. Senior unsecured debt benefits from a high unencumbered asset ratio of more than 170%, providing a large pool of collateral to debt holders.

Hybrid bonds amounting to SEK 16.5bn benefit from coupon deferral at the issuer's discretion, deep contractual subordination and a sufficiently long remaining maturity. As such, Scope grants 50% equity credit for these hybrid debt instruments.

The S-2 short-term rating is supported by a better-than-adequate liquidity, strong banking relationships, good access to diverse funding sources and access to undrawn committed credit lines with maturities beyond one year.

Stress testing & cash flow analysis
No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlooks, (General Corporate Rating Methodology, 15 July 2022; European Real Estate Rating Methodology, 25 January 2022), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, the Rated Entities' Related Third Parties and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlooks and the principal grounds on which the Credit Ratings and/or Outlooks are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlooks are UK-endorsed.
Lead analyst: Thomas Faeh, Executive Director
Person responsible for approval of the Credit Ratings: Philipp Wass, Executive Director
The Credit Ratings/Outlooks were first released by Scope Ratings on 12 November 2021. The Credit Ratings/Outlooks were last updated on 16 November 2022.

Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

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With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

Contact

Analyst	Thomas Faeh	t.faeh@scoperatings.com
Team leader	Olaf Tölke	o.toelke@scoperatings.com

Scope Ratings GmbH • Lennéstraße 5 • D-10785 Berlin • Phone: +49 30 27891-0 • Fax: +49 30 27891-0
www.scoperatings.com

Executive Board: Guillaume Jolivet, Matthias Böhm • District Court: Berlin: HRB 192993 B • VAT identification number: DE226486027