FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Swedish SBB's IDR to 'CCC+'; Unsecured Debt to 'B'; Maintains on Watch Neg

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Fitch Ratings - Warsaw - 22 Nov 2023: Fitch Ratings has downgraded Swedish property company SBB - Samhällsbyggnadsbolaget i Norden AB's (SBB) Long-Term Issuer Default Rating (IDR) to 'CCC+' from 'B-'. The senior unsecured debt rating has been downgraded to 'B' from 'B+' and its Recovery Rating remains 'RR2'. The ratings remain on Rating Watch Negative (RWN). A full list of rating actions is below.

The downgrades reflect SBB's 3Q23 results and its tight liquidity, including insufficient existing liquidity to reduce refinancing risk after end-3Q24, and unfavourable real estate and capital market conditions. SBB continues to undertake asset disposals but execution risk remains high.

With post-3Q23 SEK8 billion announced disposal proceeds from EduCo, Fitch believes SBB has sufficient liquidity to cover the bulk SEK6.7 billion 1Q24 unsecured bond maturities, and SEK1.1 billion secured debt refinancings (should banks not rollover the latter). However, assuming no deferred cash dividend in June 2024 Fitch forecasts additional liquidity is needed by end-3Q24.

Fitch expects to resolve the RWN following further information on liquidity, particularly after the results of the tender offer launched last week.

KEY RATING DRIVERS

Tight Liquidity: SBB's available liquidity at end-3Q23 was SEK2.37 billion of cash. After 3Q23, SBB expects to receive EduCo disposal proceeds totaling SEK8 billion. Together with other disposal receipts and outflows, Fitch calculates a potential liquidity shortfall during 3Q24, assuming that secured banks do not roll their facilities over, and the 2022 postponed dividend is not paid in cash. This shortfall could be after 3Q24 if secured banks roll their exposures over. SBB is therefore reliant upon further disposal proceeds to refinance debt, including its 1Q25 scheduled bond maturities totaling SEK5.3 billion.

Unreceptive Bond Market: SBB does not have capital market access to refinance its unsecured bonds. This is due to several factors, including a bondholder contesting a covenant breach, the merits of which are contentious and if it proceeds to legal action, will take time to resolve; creditors' concerns about real estate values and their effect on SBB's residential and community service portfolio, and refinance risk. Without bond market access, SBB needs to sell assets to meet debt maturities.

Tender Offer: The voluntary tender offer launched 16 November requested bids from bondholders. Fitch assumes that SBB will use its liquidity to prioritise the maturing nominal value SEK6.6 billion 1Q24 bonds (whether tendered early or awaiting maturity in 1Q24). Use of the remaining liquidity depends on banks' appetites for rolling over other near-term maturing secured facilities. SBB also has the choice of prepaying other submitted tendered bonds.

Not a DDE: Fitch does not believe that the voluntary tender offer is a distressed debt exchange (DDE) under its criteria. Investors face a genuine choice between selling discounted bonds to SBB or retaining the bonds under existing contractual terms to be repaid at par. However, the unwillingness of the issuer under the tender offer to repay bonds at par combined with the updated liquidity profile is reflected in the downgrade of the IDR to 'CCC+'/RWN.

Ongoing Plans - Disposal Proceeds: In its 3Q23 results, SBB's management showed that community service and residential real estate continues to perform well, with high occupancy and rent collection, and CPI-rent increases on long-dated leases. It also again announced plans to sell its residential portfolio, raising capital from an external equity contribution in 2024 (including an IPO or strategic partnership). Proceeds would be used to reduce leverage and repay debt. Income-producing assets are available to sell, at a price. The Fitch-calculated LTV (gross debt/investment property assets) at 3Q23 was 64%.

DERIVATION SUMMARY

The lower-yielding nature of SBB's residential rental portfolio and longer lease length than peers (from both community service assets and given the average tenure of residential assets), plus its portfolio mix, allow SBB more leverage headroom and lower interest cover than that of both commercial property-orientated Swedish peers and EMEA commercial property peers, which underpin our EMEA REIT Navigator mid-point ratio guidelines.

Fitch views SBB's real estate portfolio as stable, due to the strength of Swedish residential properties with regulated below open market rents and community-service properties' stable government-entity tenant base with longer-term leases. This is tempered by the regional location of some assets within SBB's portfolio. Its portfolio fundamentals are less sensitive to economic cycles than commercial office property companies that are reliant on open market conditions with multiple participants affecting market fundamentals.

See our previous rating action commentaries for peer analysis justifying the investment-grade quality of SBB's property portfolio before we downgraded its ratings for heightened refinancing risk.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Disposals of primarily community service properties during 2023 amounting to SEK6 billion

- Moderate 2.5%-4% rental growth in 2023-2026, driven by CPI indexation and moderate inflation

- Around SEK1 billion in residential and community service refurbishment capex per year, with a net 4%-6% income return on spend

- No acquisitions during 2027

- Building-rights profits and disposal proceeds amounting to SEK0.8 billion-SEK1 billion per year in cash flow for the next four years

- Potential payment of SEK2.1 billion postponed 2023 dividend in 2Q24, followed by cash dividends at 90% of funds from operation to 2027

RECOVERY ANALYSIS

Our recovery analysis assumes that SBB would be liquidated rather than restructured as a going concern in a default.

Recoveries are based on the 3Q23 independent valuation of the investment property portfolio. Fitch has deducted disclosed encumbered assets to total SEK61.4 billion of unencumbered investment property assets. Fitch applies a standard 20% discount to these valuations. The total amount we assume available to unsecured creditors is around SEK49.1 billion. We assume no cash is available in recovery scenarios.

After deducting a standard 10% for administrative claims, in the debt hierarchy we have deducted the recent SEK2.4 billion SBB Residential Property AB preference shares, which rank ahead of SBB's unsecured creditors. Fitch's principal waterfall analysis generates a ranked recovery for senior unsecured debt of 'RR2' (a waterfall generated recovery computation output percentage of 75%) based on current metrics and assumptions. The 'RR2' indicates a 'B' unsecured debt instrument rating. Given the structural subordination of SBB's hybrids, we estimate a ranked recovery of 'RR6' with 0% expected recoveries. The 'RR6' band indicates a 'CCC-' instrument rating, two notches below SBB's IDR.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Proof that refinancing risk has eased, including improved capital market receptivity to SBB

- Successful disposal proceeds used to prepay 2025 and 2026 debt maturities, and increasing liquidity

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Lack of progress in refinancing secured bank funding

- Actions pointing to a widespread potential renegotiation of debt terms and conditions, including any material reduction in lenders' terms sought to avoid a default

LIQUIDITY AND DEBT STRUCTURE

Tight Liquidity: SBB's available liquidity at end-3Q23 was SEK2.37 billion of cash. The previous SEK3.5 billion of available revolving credit facilities are not available for drawdown. Post-3Q23 SBB expects to receive EduCo disposal proceeds totaling SEK8 billion. Together with other disposal receipts and outflows, Fitch calculates a potential liquidity shortfall during 3Q24, assuming that secured banks do not roll their facilities over, and the 2022 postponed dividend is not paid in cash. This shortfall could be post-3Q24 if secured banks roll their exposures over. SBB is therefore reliant upon further disposal proceeds to refinance debt including 1Q25 scheduled bond maturities of SEK5.3 billion.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

SBB has an ESG credit relevance score of '4' for Governance Structure to reflect previous key person risk (the previous CEO) and continuing different voting rights among shareholders affording greater voting rights to the key person.

SBB has an ESG relevance score '4' for Financial Transparency, reflecting an ongoing investigation by the Swedish authorities into application of accounting standards and disclosures. These considerations have a negative impact on the credit profile, and are relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY	PRIOR
SBB - Samhallsbyggnadsbolaget i Norden AB	LT IDR	CCC+ Rating Watch Negative	Downgrade		B- Rating Watch Negative
	ST IDR	C Rating Watch Negative	Downgrade		B Rating Watch Negative
senior unsecured	LT	B Rating Watch Negative	Downgrade	RR2	B+ Rating Watch Negative

subordinated	LT	CCC- Rating Watch Negative Downgrade	RR6	CCC Rating Watch Negative
senior unsecured	ST	C Rating Watch Negative Downgrade		B Rating Watch Negative
SBB Treasury Oyj				
senior unsecured	LT	B Rating Watch Negative Downgrade	RR2	B+ Rating Watch Negative

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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SBB - Samhallsbyggnadsbolaget i Norden AB	EU Issued, UK Endorsed
SBB Treasury Oyj	EU Issued, UK Endorsed

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