FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms SBB at 'BBB-'; Outlook Positive

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Fitch Ratings - Stockholm - 09 Jun 2022: Fitch Ratings has affirmed Swedish property company Samhallsbyggnadsbolaget i Norden AB's (SBB) Long-Term Issuer Default (IDR) at 'BBB-' with a Positive Outlook. A full list of rating actions is below.

The ratings reflect the stability of SBB's rental income derived from its large SEK159 billion (end-1Q22, EUR15 billion) portfolio, comprising community service properties with long-term, government-linked leases and a growing share of regulated residential properties in Sweden. This is offset by high cash flow leverage that is affected by acquisition activity.

The Positive Outlook reflects expected deleveraging as SBB moderates its pace of acquisitions and continues with non-core disposals. Our revised sensitivities reflect the larger share of regulated residential properties (1Q22: 23% of net rental income) in good locations. In Fitch's view, the greater stability of the combined portfolio's residential and community service rental income allows higher debt capacity than commercial office asset peers.

KEY RATING DRIVERS

Larger Residential Share: SBB continues to invest in residential-for-rent assets, which accounted for 35% of the property portfolio value in 1Q22, and 23% of net rental income. Growth has been aided by SBB's acquisition of publicly-listed Amasten Fastighets AB (completed in 1Q22), as well as 70% of regulated-residential focused Unebo in 2021. The majority of SBB's residential portfolio is located in major urban regions in Sweden, and is regulated, with resultant below-market rents, low tenant churn rates and low vacancies. Fitch views low-yielding regulated residential as more stable than commercial property and therefore able to carry higher cashflow leverage.

Renewed Focus on Deleveraging: Following a prolonged period of acquisition-driven growth, management has publicly stated that it is focusing on deleveraging. Fitch forecasts that when implemented, this will reduce net debt/EBITDA to below 12.5x by 2024. When adjusted for the higher share of low-yielding regulated residential, this would be commensurate with a 'BBB' IDR. Fitch expects further acquisitions to be balanced by disposals.

Longer Community Service WAULT: SBB has gradually extended its community service portfolio's weighted average lease length (WAULT) to 11 years (2020: nine years, 2019: seven years). This will improve the stability of its government-linked rental income. Furthermore, the majority of SBB's shorter term leases have tenants that have been in place for 10-15 years or more, illustrating the lower vacancy risk.

The community service portfolio comprises education (schools, preschools and universities), healthcare, government infrastructure (including town halls and judiciary buildings) and publicly-funded elderly care and LSS (disabled) housing. SBB's contracts include CPI indexation, which will be beneficial in the current inflationary environment.

Growing Portfolio of JV and Associates: SBB has built up a large portfolio of joint ventures (SEK16 billion in equity value), including Svenska Myndighetsbyggnader AB and SBB Kapan AB, with institutional investor partner Kapan (manages pensions for state employees). These JVs focus on judicial/police and defence properties, and regulated residential, respectively. Additionally, SBB owns large stakes in listed developer JM AB (not rated), and residential-for-rent focused Heba Fastighets AB (not rated). Fitch includes recurring dividends from JVs and associated companies in its forecast of SBB's EBITDA.

Deleveraging Expected: Fitch forecasts SBB's net debt/EBITDA to decrease to about 13x in 2023 and 12.5x in 2024, driven by non-core disposals, like-for-like rental growth, and continued monetisation of building rights. Interest cover (Fitch's calculation including hybrid interest expense) is forecast to exceed 3x in 2022 and 3.5x in 2024. The Fitch-calculated loan-to-value (LTV), which excludes investments in listed shares and the JV portfolio, was 58% at end-2021. Fitch adjusts SBB's leverage for hybrid bonds, applying 50% equity credit to instruments issued by the parent company, while the small legacy Offentliga Hus bond receives 0% equity credit as it ranks ahead of the rated unsecured bonds.

Nordic-Focused Portfolio: SBB's property portfolio is focused on the Nordics, with Sweden comprising the majority (75% of value), Norway (17%) and the remainder of the portfolio in Finland and Denmark. The properties are located in growing city regions with positive demographic trends and above-average disposable incomes. About 45% of the portfolio is located in the Nordic capital regions, and in Gothenburg or Malmo and the greater Malardalen region. The remainder is located in university towns or regional cities.

Niche Community Service Assets: SBB's portfolio by value is around 65% community service and office properties and around 35% regulated residential. The community service properties have an indirect and direct government tenant base, including government departments, municipalities, education, elderly care, and LSS group housing. The passing rent for the combined group was SEK7.3 billion at end-1Q22. Fitch views SBB's long-term, government-linked rental income as lower risk and able to carry higher leverage than commercial properties.

Unsecured Capital Structure: SBB maintains a primarily unsecured capital structure, which includes SEK125 billion of investment properties with no secured pledges. At end-1Q22, these unencumbered assets covered SBB's SEK59 billion of unsecured debt (bonds and commercial paper) by more than 2x.

DERIVATION SUMMARY

With 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), and its portfolio mix, Fitch has allowed SBB more leverage headroom and lower interest cover than for (i) commercial property-orientated Swedish peers; and (ii) EMEA commercial property peers that underpin our EMEA REIT Navigator mid-point guidelines.

Fitch views SBB's portfolio as stable, due to the strength of Swedish residential properties with regulated below-open market rents and community service properties' stable 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 respective market fundamentals.

Assura plc (A-/Stable) builds and owns modern general practitioners' (doctors) facilities in the UK, with approved rents indirectly paid by the state National Health Service (NHS) and similar 11.7 years WAULT. Its portfolio was much smaller than SBB's at GBP2.6 billion. Reflecting Assura's community service activities, a 4.6% net initial yield (SBB: 3.8%), 99% occupancy rate, and specific-use assets, the company's downgrade rating sensitivity to 'BBB+' includes net debt/EBITDA greater than 9x, compared with SBB's blended upgrade metric to 'BBB' below 12.5x net debt/EBITDA. In part, this acknowledges the wider diversity of SBB's larger portfolio, including residential rental exposure, and lower SEK interest rate environment (as reflected in tighter property yields). Net interest cover (NIC) is more difficult to compare, as the companies have different interest rate environments. Assura's NIC is markedly higher than SBB's at 4x.

The smaller, but community service-akin Civitas Social Housing PLC and Triple Point Social Housing PLC (both A-/Stable) have the same 'BBB+' leverage downgrade rating sensitivity as Assura for their long WAULT, low vacancy rate, and special needs accommodation that also has a government rental income covenant (sourcing housing benefit). Annington Limited (BBB/Stable) is less comparable with SBB as it has a direct UK Ministry of Defence rental covenant for its military housing portfolio with no void or maintenance cost risks.

These peers have not had SBB's significant merger and acquisition activity.

KEY ASSUMPTIONS

- Moderate rental growth driven by higher CPI indexation.

- Around SEK1 billion in residential and community service refurbishment capex per year, which has a net 5-6% return on spend.

- Disposal of SEK7 billion of non-core assets in 2022. Thereafter a moderate pace of asset rotation.

- Building rights profits and disposals amounting to SEK1.5 billion per year in the cash flow for each of the next four years.

RATING SENSITIVITIES

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

- Net debt/EBITDA of less than 12.5x (2022 pro forma: around 14.5x) based on the current portfolio mix of around 25% residential by net rental income

- EBITDA net interest cover greater than 3.0x

- Unencumbered investment property assets/unsecured debt above 2.0x

- Weighted average debt maturity above five years

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

- Net debt/EBITDA greater than 14x

- EBITDA net interest cover below 2.0x

- 12-month liquidity score below 1.0x

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: At end-1Q22, SBB had adequate liquidity comprising SEK8.9 million in readily available cash and SEK6.8 billion of undrawn credit facilities that do not mature in the next 12 months. This covers SEK5.1 billion of bonds and bank debt, and SEK6.3 billion of commercial paper maturing within 12 months.

During 1H22, SBB issued its first euro-denominated EUR700 million unsecured social bond and its first Schuldschein debt instrument. The social bond was issued with a negative interest rate, and the Schuldschein at EURIBOR plus 145bp and 170bp with three- and five-year maturities, respectively. The group's average cost of debt excluding hybrid coupons was 1.24% at end-1Q22.

ISSUER PROFILE

SBB is a Nordic property owner specialising in community service and residential properties.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
SBB - Samhallsbyggnadsbolaget i Norden AB	LT IDR	BBB- Rating Outlook Positive	Affirmed	BBB- Rating Outlook Positive
	ST IDR	F3	Affirmed	F3
subordinated	LT	BB	Affirmed	BB
senior unsecured	LT	BBB-	Affirmed	BBB-
senior unsecured	ST	F3	Affirmed	F3
SBB Treasury Oyj				
senior unsecured	LT	BBB-	Affirmed	BBB-

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. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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

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