



RATING ACTION COMMENTARY

Fitch Affirms Swedish Property Company SBB at 'BBB-', Stable Outlook

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Fitch Ratings - Stockholm - 06 Apr 2020: Fitch Ratings has affirmed the Swedish property company Samhallsbyggnadsbolaget i Norden's AB's (SBB) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB-' and subordinated debt rating at 'BB'. The Outlook is Stable.

Following December 2019's acquisition of Hemfosa, SBB needs to complete planned disposals to reduce its leverage. Last week Nyfosa withdrew its offer to acquire one tranche of planned disposals, but Fitch understands that this is not representative of wider domestic market conditions, particularly for community service assets, which are less affected by coronavirus events. To maintain its rating, Fitch has calculated that SBB needs to sell at least SEK10 billion of assets this year (SEK2 billion achieved).

Fitch expects there will be a limited impact on rental income from SBB's portfolio of community service properties due to the economic effects of the coronavirus, considering its often government-linked tenants and the nature of its schools, LSS (disabled)-housing and other community service properties, and regulated residential. This will provide stability to SBB's cash flows compared with peers more exposed to retail store closures or tenants with weaker tenant quality.

KEY RATING DRIVERS

Minimum Level of 2020 disposals: After the Hemfosa acquisition, our forecasts of deleveraging towards 10x net debt to EBITDA at end-2020 relied upon SBB executing a significant amount of planned disposals under conducive market conditions. In maintaining SBB's rating, Fitch calculates that an assumed level of SEK10 billion of near-term disposals are needed to enable it to reach 10x net debt/EBITDA. SEK2 billion has been achieved so far.

A further improvement in SBB's financial profile would depend on successful disposals thereafter. Meanwhile, interest cover and liquidity remain strong.

Niche Community Service Assets: The combined SEK80 billion portfolio of SBB and Hemfosa is focused on community service properties and regional residential. The community service properties have an indirect and direct government tenant base including government departments, municipalities, elderly care, and LSS group housing. The passing rent for the combined group was SEK5.2 billion at end-2019. SBB's profile is supported by the resilient nature of its rental cash flows.

Improved Interest Cover: SBB completed significant refinancing during 2019, which has lowered its average interest cost to 1.76% at year-end (excluding hybrids). In 1Q20, SBB has issued EUR800 million of unsecured bonds, of which EUR50 million was a 20-year bond with 2.75% coupon and EUR500 million of hybrid bonds. As a result of the completed refinancings, EBITDA net interest cover is expected to improve to above 3x in 2020 and around 4x in 2021 from 1.7x in 2019, a significant improvement. The option to defer its hybrid interest payments provides further flexibility.

Fitch includes 100% of hybrid interest costs in its interest cover ratios and SBB's hybrid bonds have received 50% equity credit in its leverage calculations.

Redeeming Hemfosa Minorities. The Hemfosa acquisition was made with a combination of cash and shares in SBB. In 1Q20, SBB acquired 93.5% of shares in Hemfosa, and has called for a mandatory redemption of the remaining minorities. We have included a SEK2 billion net cash outflow during 2020 (including net cost of shares acquired after year-end) in our forecast.

Bespoke Nature of Some Assets: The community service-orientated portfolios contain some bespoke regional and niche assets such as education, city halls,

regional municipal offices, and elderly people's apartments. Although on long-dated leases (averaging around seven years), their rental evidence may be difficult to ascertain. However, these leases have contractual indexed uplifts. Historically, these tenants have tended to be "sticky" and stay in the locality they serve. Occupancy is above 95%.

For these types of niche assets, Fitch believes that there are a growing number of alternative domestic investors, albeit less than the investor depth in other domestic commercial property. SBB's residential portfolio (17% of the combined group) is regional and benefits from the stability of rents under Sweden's rental regulation and a shortage of available rented housing.

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 average tenure of residential assets), and portfolio mix, Fitch would allow the combined group more leverage headroom and lower interest cover than (i) commercial property orientated Swedish peers; and (ii) EMEA peers with commercial property companies that underpin our EMEA REIT Navigator mid-point guidelines.

Fitch views the combined group's portfolio as more stable due to the strength of Swedish residential property with its regulated below-open market rents and the community service properties' stable tenant base with longer-term leases. This is slightly tempered by the regional location of assets. Community service assets' 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.

KEY ASSUMPTIONS

- Completion of 2020's planned, sizeable, disposal programme to achieve lower financial leverage.
- We have updated the combined group's financial profile using provisional 1Q20 data on rents and margins.
- Acquisition of remaining Hemfosa minority via mandatory redemption.

- Conversion of additional cash-like items (receivables from JV and others receivables) to readily available cash.
- SEK5 billion cumulative inflow from SBB's building right disposals and related JVs until 2023.
- Around SEK2.5 billion of capex with 10-15 years repayment period.
- Organic rental growth of 2.0% to 2.5% per year including indexation.

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Net debt to EBITDA of less than 9.5x (funds from operations (FFO)-based net equivalent under 10.5x) (pro forma net debt to EBITDA FY 2020: around 10x)
- Fixed charge cover (FCC) ratio greater than 2.3x
- Unencumbered asset cover above 2.0x
- Well-laddered debt maturity schedule with longevity

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Net debt to EBITDA greater than 10x
- Non-completion of the material 2020 disposal programme
- Portfolio acquisitions that (due to being over-priced) reduce FCC below 1.8x
- Group LTV approaching 60% (compared with individual propco covenant breach levels of 70%-75%)
- 12-month liquidity score below 1.0x

BEST/WORST CASE RATING SCENARIO

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 <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: At end-2019, SBB had SEK12.8 billion in cash on balance sheet and SEK1.0 billion in short-term investments. Around SEK8 billion of the cash was reserved for payment to Hemfosa shareholders in early January (treated as restricted cash). This left SEK5.7 billion of readily available cash in addition to SEK7.1 billion of committed undrawn credit facilities (in total SEK12.9 billion). The available liquidity covered SEK10.3 billion of maturing bank, bond and commercial papers in 2020. In 1Q20, SBB completed major bond issuances; a EUR500 million hybrid bond, a EUR750 million unsecured bond and a EUR50 million unsecured 20-year bond (in total more than SEK13 billion) further strengthening SBB's liquidity.

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

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT

RATING

ENTITY/DEBT	RATING		
SBB - Samhallsbyggnadsbolaget i Norden AB	LT IDR	BBB-	Affirmed
● subordinated	LT	BB	Affirmed
● senior unsecured	LT	BBB-	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Corporates Notching and Recovery Ratings Criteria \(pub. 14 Oct 2019\)](#)
(including rating assumption sensitivity)

[Corporate Hybrids Treatment and Notching Criteria \(pub. 11 Nov 2019\)](#)

[Corporate Rating Criteria \(pub. 27 Mar 2020\)](#) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.8.0 ([1](#))

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

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