

Research Update:

Samhallsbyggnadsbolaget i Norden AB Outlook Revised To Positive; 'BBB-' Ratings Affirmed

March 1, 2021

Rating Action Overview

- Samhallsbyggnadsbolaget i Norden AB (SBB) significantly increased its property portfolio over the past 12-18 months to about Swedish krona (SEK) 90 billion as of fourth-quarter 2020, from SEK31 billion as of third-quarter 2019, materially enhancing its absolute cash flow and earnings base.
- At the same time, SBB reduced its leverage thanks to active asset disposal, equity issuance, and a positive asset revaluation, with our adjusted debt plus debt plus equity ratio falling to 52.5% as of fourth-quarter 2020 compared with 61.2% as of fourth-quarter 2019.
- We are therefore revising our outlook on SBB to positive from stable and affirming our 'BBB-' issuer credit rating on the company. We are also affirming our 'BBB-' ratings on the senior unsecured debt and 'BB' rating on the subordinated hybrid instruments.
- The positive outlook reflects our view that we could raise the ratings on SBB within 12 months if its adjusted debt to debt plus equity remains well below 55% on a sustainable basis, and its interest cover ratio and debt to EBITDA improve in line with our base case.

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Rating Action Rationale

Thanks to SBB's focus on deleveraging, despite its strategy to continue to expand its portfolio, we expect the company will maintain or improve its credit metrics over 2021-2022. The revised outlook reflects our view that SBB's credit metrics strengthened more than we anticipated in 2020, primarily due to asset disposals of about SEK13.5 billion, but also thanks to a high positive portfolio revaluation of about SEK8.6 billion, corresponding to a 9% portfolio increase, as well as some equity injections. The company's S&P Global Ratings-adjusted debt to debt plus equity stood at 52.5% on Dec. 31, 2020, versus 61.2% on the same date last year, including our adjustments for hybrid bonds. Interest coverage also improved to 2.7x at year-end 2020 from 1.8x at year-end 2019, thanks to some reduction in cost of debt and enhanced earnings. We forecast S&P Global Ratings-adjusted debt to debt plus equity at 52%-53% over the next 12-24 months, and improved EBITDA interest coverage of above 3x, supported by increasing cash flows from recent acquisitions and low average interest rates of 1.6%-1.7% for the senior debt (excluding

hybrid bonds). Nevertheless, we anticipate SBB's debt to EBITDA will likely remain elevated at 15x-16x, underpinned by its growth strategy and a lower yield.

We anticipate that SBB will continue to pursue its growth strategy in the community service properties and regulated residential sectors. However, we expect the company will use a balanced mix of debt and equity in line with their financial policy. A series of transformative acquisitions in the past few years has increased its assets to SEK90.2 billion as of fourth-quarter 2020 from less than SEK25.0 billion at year-end 2018. SBB has continued to expand its portfolio and purchased assets of about SEK15 billion in 2020.

We expect SBB will maintain both lower leverage and adequate liquidity. During 2020, SBB revised its financial policy and has now committed to more conservative financial targets, in particular a reported loan-to-value (LTV) ratio, defined as debt to debt plus equity (including 50% of hybrid instruments treated as debt), remaining below 50%. This commitment is reflected by SBB's capital market access, with two hybrid issuances of €500 million each at an average rate of 2.6%, a mandatory convertible bond of SEK2.75 billion, and an equity issuance of SEK600 million-SEK700 million. In addition, SBB's funding and liquidity remains solid. We note large upcoming debt maturities in the next 12 months, amounting to about 18% of total debt including commercial paper (SEK10.2 billion). That said, we understand the company intends to roll over existing maturities. In addition, company holds substantial cash of SEK13.6 billion, and SEK7.1 billion available under its committed undrawn backup facility as of Dec. 31, 2020. Therefore, we note company's ability to maintain adequate liquidity in spite of its growth strategy.

SBB will continue to strengthen its position in specialized public properties and regulated residential markets. Our rating on SBB is supported by the company's large and well-diversified property portfolio within community services and regulated residential markets, where underlying demand remains strong and new supply is moderate. In our view, SBB has a positive operational track record, with like-for-like rental income of 3.2% in 2020, enhanced by its refurbishment program and a strong occupancy rate of 97%-98%, excluding vacant premises for renovation. In addition, the portfolio is characterized by long lease contracts of nine years on average, and creditworthy tenants including municipality or government-related tenants, translating into good cash flow visibility. In our view, the company has strengthened its position in public service properties in the past year, for example, by increasing its share in Elderly Care (15% of rental income in 2020), supported by a major Finnish acquisition. We view these assets as more specialized, with less risk for substitution than other properties within the sector. We anticipate that SBB will continue to further expand within this subsegment. As of year-end 2020, SBB owns a building right portfolio of about 2.5 million square meters, increased with recent acquisitions and newly formed joint ventures. We understand the company's recent expansion into development activities, which we view as riskier, but expect the overall exposure will remain limited.

Our comparable rating analysis modifier remains negative. This reflects the company's limited track record of maintaining improved leverage ratios and managing risks related to its growth strategy compared with other higher-rated real estate peers with more stable portfolios. SBB has expanded significantly in the past few years with series of transformative acquisitions. However, we note a limited track record of stable operations due to the large amount of acquisitions and disposals over the past 18 months, in line with the company's growth strategy, and remain cautious regarding the impact of portfolio revaluations or potential higher investment costs from newly acquired assets or development activities.

Outlook

The positive outlook reflects our view that we could raise the ratings on SBB within 12 months if its adjusted debt to debt plus equity remains well below 55% on a sustained basis, and its interest cover ratio and debt to EBITDA improve to and are maintained at above 3.0x and 15x-16x, respectively, reflecting the company's commitment to its new financial policy.

At the same time, we would expect SBB to continue to expand its portfolio in line with its growth strategy, while at the same time exhibiting financial discipline. An upgrade would be contingent on SBB successfully integrating recent acquisitions, achieving the anticipated synergies, and establishing an operational record with a maturing portfolio. This would result in good visibility and predictability of cash flows.

Our outlook also reflects our expectations of continued favorable market fundamentals for SBB's portfolio, supporting cash flow generation via high demand from its resilient asset segments, community service properties, and midrange residential apartments, where demand will not exceed supply trends.

Downside scenario

We could revise the outlook to stable if the company fails to reach its leverage targets of debt to debt plus equity of well below 55% on a sustained basis. This could most likely occur following higher-than-expected debt-financed acquisitions or investments, or if its operating performance is materially weaker than our forecast.

We could also revise the outlook to stable if EBITDA interest coverage does not improve above 3.0x on a sustainable basis or if debt to annualized EBITDA materially differs from our forecast. In addition, we would view negatively further unforeseen events that affect the company's operating performance or harm its overall credit risk profile.

Company Description

SBB is one of the largest listed real estate companies in the Nordics and has a portfolio value of SEK90.2 billion (€9.0 billion as of December 2020). SBB mainly invests in community service properties (74% of total portfolio value) and Swedish regulated residential properties (20%). In addition, the company owns other properties, mainly commercial assets, with identified development potential (6% of portfolio value), for which it seeks to obtain building rights to be sold afterward. The portfolio is in the Nordic region, with 70% in Sweden. The company has entered two other Nordic markets: Finland (in 2018) and Denmark (in 2019).

Our Base-Case Scenario

Assumptions

In our base case we assume:

- Annual like-for-like rental income growth of 1.5%-2.0% for SBB's properties in the next two years.

- Stable occupancy rate of 97%-98%, reflected in strong anticipated demand.
- A slight improvement in EBITDA margin to 62%-63% for the next 12-24 months following synergies from the acquisition.
- 3.0%-3.5% like-for-like overall portfolio revaluation for 2021-2022, supported by sound demand and limited supply features in SBB's markets. In our forecasts we also factor in additional uplift from property development.
- Annual capital expenditure (capex) of SEK2.0 billion-SEK 2.2 billion in the next 12 months, including development projects (mix of joint ventures, turnkey, and direct development) as well as capitalized maintenance, mainly invested in its Swedish property portfolio, in line with the company's strategy.
- We expect SBB will be a net buyer and expand its portfolio in the coming years, with limited asset disposals. We forecast average costs at 1.6%-1.7%, excluding the outstanding hybrid instrument.

Key metrics

Based on these assumptions, we arrive at the following credit measures over the next 12-18 months:

- EBITDA to interest coverage above 3.0x from 2021, compared with 2.7x for the 12 months ended Dec. 31, 2020;
- Adjusted debt to debt plus equity remaining at 52%-53% in 2021, with marginal further improvement in 2022; and
- Debt to EBITDA of 15x-16x, including the full year effect of 2020 acquisitions.

Liquidity

We assess SBB's liquidity as adequate, based on our estimate that the company's liquidity sources will likely cover uses by more than 1.2x in the 12 months starting Dec. 31, 2020. SBB's high cash balances and SEK27 billion revolving credit facility (RCF) enhances the company's liquidity position. We assume that SBB will continue to renew its short-term line of credits as it has done in the past. We exclude from our analysis disposals and acquisitions, since they are not committed.

We currently assess that available sources should comfortably cover uses of liquidity. However, our liquidity assessment is currently limited at adequate.

Principal liquidity sources include:

- SEK 13.6 billion in available unrestricted cash;
- The SEK 7.8 billion RCF with a maturity of more than 12 months;
- Our estimate of funds from operations of SEK3.0 billion-SEK3.3 billion; and
- Positive working capital inflow with regards to receivables against sold properties of SEK2.4 billion.

Principal liquidity uses include:

- SEK 10.2 billion of contractual debt amortization payments, of which we understand SEK5.2 billion refers to commercial paper;
- Dividends of about SEK1.8 billion; and
- Capex of SEK2.0 billion-SEK2.2 billion, although we understand most of it is not committed.

Covenants

We understand that SBB needs to comply with covenants for its existing bond issuances and credit lines. We estimate that the headroom under these covenants is adequate, at more than 10%.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of fourth-quarter 2020, SBB's capital structure consisted mainly of senior unsecured bonds (SEK37.8 billion), traditional bank loans (about SEK12.1 billion), commercial paper (SEK5.4 billion) and hybrid bonds (SEK14.5 billion). At Dec. 31, 2020, the proportion of interest-bearing liabilities with fixed interest was 95%, with an average debt maturity of 4.8 years.

Analytical conclusions

We rate SBB's senior unsecured bonds in line with the 'BBB-' issuer credit rating given the limited portion of secured debt (secured debt to total assets was 10% as of fourth-quarter 2020). We believe the ratio will remain below our threshold of 40%. The subordinated hybrid notes are rated 'BB', two notches below the issuer credit rating, as per our approach for hybrid capital.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Positive/A-3

Business risk: Strong

- Country risk: Very low
- Industry risk: Low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral
- Capital structure: Neutral

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- Liquidity: Adequate
- Financial policy: Neutral
- Management and governance: Fair
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bbb-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Outlook Action; Ratings Affirmed To		From
Samhallsbyggnadsbolaget i Norden AB (publ)		
Issuer Credit Rating	BBB-/Positive/A-3	BBB-/Stable/A-3
Ratings Affirmed		
Samhallsbyggnadsbolaget i Norden AB (publ)		
Senior Unsecured	BBB-	BBB-
Subordinated	BB	BB
Commercial Paper	A-3	A-3
SBB Treasury OYJ		
Senior Unsecured	BBB-	BBB-

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