MONDAY, 18/09/2023 - Scope Ratings GmbH

Scope downgrades SBB’s issuer rating to CCC under review for a developing outcome

Weaker leverage and interest coverage, slow progress on the strategic review, liquidity and governance concerns and the dependence on asset sales to fund short-term debt obligations drive the downgrade.

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 downgraded the issuer rating of Samhällsbyggnadsbolaget i Norden AB (SBB) to CCC from BB- under review for a possible downgrade. Scope has also downgraded the senior unsecured debt rating to B- from BB- under review for a possible downgrade and the subordinated (hybrid) debt rating to CC from B- under review for a possible downgrade. Scope has confirmed the short-term debt rating at S-4. Scope has placed all ratings under review for a developing outcome.

Rating rationale

The rating downgrades are driven by liquidity concerns, the deteriorating credit metrics, and governance and transparency concerns. Scope’s rating case assumes that SBB’s Scope-adjusted loan/value ratio and EBITDA interest cover will continue to weaken and that assets disposals will still be needed to preserve liquidity and cover short-term debt maturities. The strategic review has not yet revealed significant results that have improved credit metrics, liquidity or access to capital markets. As such Scope sees heightened liquidity risks with the large upcoming maturity in February 2024. Further downside pressure comes from SBB’s repeated restatement of quarterly reports and inadequate transparency around their publication and the lack of transparency and progress in its strategic review. Scope will closely monitor any developments regarding the disposal of properties and an anticipated comprehensive plan to address upcoming maturities over the next 18 months and has thereby placed all ratings under review for a developing outcome.

The business risk profile (unchanged at BBB+) could come under pressure from a partial sale of either SBB or a significant share of its assets. Exclusive discussions with Brookfield to buy SBB’s remaining 51% stake in their EduCo joint venture, announced on 26 June 2023, have since been discontinued[1]. The market share and diversification assessments could be affected by i) a smaller size decreasing SBB’s visibility to tenants; or ii) a higher concentration of tenants, properties and geographies. Asset quality and operating profitability are also highly dependent on asset disposals.

The financial risk profile has deteriorated further to B- from BB-. Deteriorations in credit metrics were largely due to fair value depreciations in SBB’s portfolio and its joint ventures, as highlighted in the Q2 report; asset sale proceeds during June 2023 to provide liquidity and deleveraging were insufficient to compensate. As such the loan/value increased to 59% at Q2 2023. Scope expects the ratio to remain at such levels until year-end 2023 due to a lack of deleveraging disposal activities and further pressure on SBB’s asset values, and despite a SEK 2.4bn preference share issuance in August 2023. The disposal of SBB’s remaining 51% share in the EduCo portfolio could have provided needed relief on credit metrics, such as Scope-adjusted EBITDA interest cover, leverage and the longer-term liquidity assessment, but is no longer an option. Scope notes that the company has released letters of intent for SEK 3bn of disposals, to be signed during the third quarter 2023, but progress has been slow. Scope-adjusted interest cover is expected to deteriorate to 2.0x by year-end 2023, from 2.7x LTM as of Q2 2023, and further to 1.8x in 2024.

The recent and expected disposals are borne of necessity to ensure sufficient liquidity and address upcoming debt maturities. Liquidity is inadequate as the company’s external and internal funding capabilities are curtailed. All these factors are contributing to restricting SBB’s access to capital markets, resulting in an expected further increase in funding costs and complicating asset sales under its strategic review, as witnessed by its slower-than-expected progress. This comes on top of general negative sentiment among real estate investors that is expected to result in further fair value depreciations.

The inadequate liquidity is shown by the only 0.6x coverage of uses by liquid sources for the 12 months ending June 2024. At Q2 2023, SBB had SEK 8.4bn of bonds (of which 79% in Q1 2024; a EUR 559m bond), SEK 2.3bn of drawn revolving credit facilities, SEK 3.5bn of secured bank maturities, and SEK 320m of commercial paper maturing within 12 months (since reduced to SEK 56m). Sources are SEK 1.7bn of unrestricted cash, SEK 2.5bn of unutilised credit facilities, SEK 2.4bn of proceeds from the preference share issuance and SEK 1.9bn of free operating cash flow. Scope expects secured bank debt and revolving credit facilities to be rolled over and refinanced, which leaves the maturing unsecured bond debt just about covered by liquidity. However, banks have become stricter towards real estate customers, demanding a more proactive restructuring of assets and deleveraging. Refinancing on an unsecured basis has therefore become unlikely, and banks are increasingly requiring deleveraging before granting credit. SBB is therefore likely to refinance unsecured debt beyond the next 12 months by disposing of assets at potentially unfavourable values, driving Scope’s heightened liquidity concerns. However, the implementation of a comprehensive refinancing plan covering the next 18 months of maturities may help to alleviate these concerns.

Lastly, Scope highlights the negative governance issues (ESG factor: credit-negative) that have resulted in a negative one-notch adjustment of SBB’s standalone rating. These stem from an investigation by the Swedish financial services authority into violations of accounting provisions linked to restatements of the 2021 annual accounts, repeated negative press regarding an alleged covenant breach (which the company disputes), and the recent repeated restatement of quarterly reports and the inadequate handling of their publication[2]. The recent replacement of the CFO with an internal candidate also does not benefit Scope’s governance assessment. On top, these issues are fuelling negative market sentiment. That is reflected in a negative adjustment of the standalone rating by one notch.

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

Under review for a developing outcome

Scope will closely monitor any developments regarding the disposal of properties and the anticipated comprehensive plan addressing upcoming maturities over the next 18 months. Scope will also monitor the use of proceeds and the impact any partial sale would have on portfolio value. Scope will resolve the under-review status once there is sufficient clarity on the implementation of SBB’s strategic review.

A prerequisite for an upgrade is the implementation of a comprehensive restructuring of assets that leads to a reduction in leverage and a noticeable improvement in SBB's liquidity, e.g. if planned disposal proceeds and/or refinancing can cover maturities over the next 18 months. Furthermore, any plan should not involve a restructuring of liabilities that leads to losses for SBB’s creditors.

A downgrade could be triggered either by a deterioration in SBB's liquidity, e.g. the loss of undrawn revolving credit facilities to bridge short-term refinancing needs, or by the failure to roll over secured bank debt. A downgrade could also be triggered if the company were to restructure liabilities in a way that leads to losses for debt holders, though Scope considers this unlikely and has not reflected this scenario in its base case.

Long-term and short-term debt ratings

As of 30 June 2023, SBB had SEK 49.5bn in senior unsecured debt outstanding. Senior unsecured debt benefits from an unencumbered asset ratio of more than 125% that provides a pool of collateral to debt holders. Based on Scope’s General Corporate Rating methodology and reasonable discounts on the company’s asset base, Scope expects a superior recovery for senior unsecured debt. However, advance rates are uncertain in the case of a hypothetical issuer default. Scope also highlights the high sensitivity of advance rates and the volume of senior secured debt at the point of a hypothetical default, resulting in the downgrade of the senior unsecured debt rating to B- from BB- under review for a possible downgrade. The rating has been placed under review for a developing outcome.

Hybrid bonds amounting to SEK 15.7bn (as of Q2 2023) benefit from coupon deferral at the issuer’s discretion, deep contractual subordination and a long remaining maturity. Scope grants 50% equity credit for these hybrid debt instruments. The recovery for subordinated unsecured debt is highly dependent on used advance rates. Consequently, the rating has been downgraded to CC from B- under review for a possible downgrade. The rating has been placed under review for a developing outcome.

Scope has confirmed the short-term debt rating at S-4. The rating is based on the issuer rating of CCC under review for a developing outcome and reflects the worse-than-adequate liquidity and the curtailed access to capital markets. However, SBB still has access to banks and to undrawn committed credit lines with maturities beyond one year. The rating has been placed under review for a developing outcome.

Rating driver references

1. SBB i Norden – company news, 21 July 2023
2. SBB i Norden – company news, 10 August 2023

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, (General Corporate Rating Methodology, 15 July 2022; European Real Estate Rating Methodology, 25 January 2023), 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 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 the principal grounds on which the Credit Ratings are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings are UK-endorsed.
Lead analyst: Thomas Faeh, Executive Director
Person responsible for approval of the Credit Ratings: Philipp Wass, Managing Director
The Credit Ratings were first released by Scope Ratings on 12 November 2021. The Credit Ratings were last updated on 28 June 2023.

Potential conflicts

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

Conditions of use/exclusion of liability

SHARE

CONTACT INFO

Thomas Faeh

Analyst

t.faeh@scoperatings.com

Olaf Tölke

Team leader

o.toelke@scoperatings.com

Press contact

press@scopegroup.com

ISSUERS **1**

INSTRUMENTS **20**