

Research Update:

Samhallsbyggnadsbolaget Downgraded To 'CCC+' On Upcoming High Debt Maturities And Liquidity Pressure; Outlook Negative

July 28, 2023

Rating Action Overview

- Swedish real estate landlord Samhallsbyggnadsbolaget i Norden AB (SBB) faces significant short-term debt maturities, which weigh on the company's liquidity position. These maturities consist of about Swedish krona (SEK) 14.6 billion within the next 12 months.
- Securing sufficient funding needs is taking longer than expected, and we believe SBB's access to capital markets remains remote. We also think the company is increasingly dependent on favorable economic circumstances such as generating sufficient asset sales in challenged markets to meet its short-term obligations, which in our view further increases liquidity risk.
- In addition, the company's credit metrics have weakened during second-quarter 2023, with S&P Global Ratings-adjusted debt to debt plus equity increasing to 65.5% from 59.9% in first-quarter 2023, mainly because of property devaluations, unexpected translation losses, and value losses on financial investments.
- Therefore, we lowered our long-term issuer credit ratings on SBB to 'CCC+/C' from 'BB-/B', our issue ratings on its senior unsecured debt to 'CCC+' from 'BB-', and our issue ratings on the subordinated hybrid bonds to 'CC' from 'B-'. The recovery rating of '3' on the senior unsecured debt remains unchanged.
- The negative outlook reflects high uncertainty regarding SBB's ability to successfully secure sufficient funding to cover its short-term debt maturities within the next few months.

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Rating Action Rationale

The downgrade reflects the short time before significant upcoming maturities are due, currently insufficient liquidity sources, and increased dependency on favorable economic circumstance such as generating sufficient asset disposals. On July 14, 2023, SBB reported its second-quarter results, with a drop in available cash on balance sheet to SEK1.7 billion (versus SEK5.3 billion in first-quarter 2023) and a slight increase in short-term debt maturities for the

next 12 months to SEK14.6 billion (versus SEK14.2 billion in first-quarter 2023). In addition, on June 21, 2023, SBB's board of directors resolved that the dividend for all share classes of about SEK2 billion, approved by the 2023 annual general meeting in April 2023, shall be distributed at the latest on June 28, 2024.

SBB has made some small disposal transactions over the past couple of weeks, including the sale of most of its stake in Heba Fastighets AB for about SEK491 million. It has created a residential subsidiary, SBB Residential Property AB, with a property value of SEK6.2 billion, which will issue a SEK2.36 billion of preference shares to Morgan Stanley Real Estate Investing. Despite these transactions, the liquidity deficit has further intensified and become increasingly unsustainable.

Of the SEK14.6 billion short-term debt maturities, approximately SEK8.5 billion are related to bonds due within the next seven months, including a nominal €700 million senior unsecured bond with outstanding €559 million (about SEK6.5 billion), due Feb. 8, 2023. In our view, the financial pressure on SBB has increased over the past few weeks. The company's spreads of its traded bonds remain beyond the sector average. We think SBB's ability to access funding sources is deteriorating, and we understand that the company has entered discussions with bondholders on potential secured financing and accuracy of reset covenant test, though at very early stages. We therefore revised our liquidity assessment to weak from less than adequate.

We understand that SBB has discontinued its discussions with Brookfield on the sale of the remaining 51% stake in EduCo., dampening the likelihood of a prompt liquidity boost. On July 21, 2023, SBB announced that discussions have stopped with its existing partner Brookfield regarding SBB's potential sale to Brookfield of its 51% stake in EduCo (Brookfield already owns 49%). The discussions had also involved the repayment of the SEK14.5 billion intercompany loan, provided by SBB to EduCo. In our view, this transaction could have provided a powerful boost to the SBB's liquidity position in the short term. With this transaction now unlikely over the next few months, SBB's refinancing pressure has increased. While the liquidity risk is currently severe, we assume in our base case that SBB will eventually raise funds through asset sales or secured financings to meet short-term obligations.

We revised our business risk profile to satisfactory from strong following the company's delay in securing sufficient funding and uncertainty around its strategic portfolio review, including the ability to time and quantify its disposal plans, as well as its increasingly complex portfolio structure. The revision reflects the uncertainty of the company's execution and timing of its strategic review, as well as the current difficulties in the transaction market--with the size, price, and timing of a potential transaction remaining unclear.

Including subsidiaries EduCo and SBB Residential Property AB, approximately 35% of SBB's total property portfolio is now located in subsidiaries with strong minority interests. Although those transactions help the company receive cash to support liquidity and deleveraging plans, we think they add complexity to the corporate structure, because the company does not have full access to those entities' cash flows while it fully consolidates those subsidiaries. We recognize that SBB will no longer accrue the full benefits of EduCo and SBB Residential Property AB's cash flows, reducing its capacity to serve its financial commitments at the holding level.

Our updated base case takes into account SBB's reported translation and value losses during second-quarter 2023, as well as higher funding costs, which led us to revise our financial risk profile to aggressive. In second-quarter 2023, the company reported approximately SEK4.1 billion of translation and value losses, the latter related to its financial instruments. Together with a negative revaluation on its property portfolio of about SEK8 billion, the S&P Global

Ratings-adjusted debt-to-debt-plus-equity ratio increased to 65.5% from 59% in first-quarter 2023. In addition, we forecast very little dividend contribution from joint ventures and associated companies that could support our EBITDA calculation for future years (about SEK300 million received for full-year 2022), following the sale of the majority of its stake in JM AB.

We view the recently issued preference shares of SEK2.36 billion to Morgan Stanley Real Estate Investing as 100% debt under our criteria and its coupon payments as interest costs, because we understand the documentation includes early redemption provisions for the holder and exit rights after five years that question the instruments' permanency in the capital structure and could be refinanced with ordinary debt, in our view. While we expect strong positive like-for-like rental growth of about 8.0% over the next 12 months, as well as sustained high occupancy rates of 95% to 96%, we do not expect this will fully mitigate the loss in received dividends and higher funding costs. We therefore now expect the company's EBITDA interest coverage at 1.7x to 1.8x in 2023 (versus about 1.8x rolling 12 months as of June 30, 2023, and about 2x in our previous forecast) and our debt-to-debt-plus-equity ratio to remain close to 65% in 2023 (versus 60% in our previous base case). We expect the ratio of debt to EBITDA to remain high at about 18x.

We lowered to 'CCC+' our issue ratings on SBB's senior unsecured debt and to 'CC' our issue ratings on SBB's subordinated debt. The issue ratings on the senior unsecured debt remain in line with the issuer credit rating. Our recovery analysis on SBB is unchanged at '3', in line with our criteria. For its subordinated rated notes, we continue applying three notches difference from the issuer credit rating. We may review our approach for the hybrid bond ratings if we believe the risk of coupon deferral increases beyond our current assessment.

Outlook

The negative outlook reflects high uncertainty regarding SBB's ability to successfully secure sufficient funding to cover its short-term debt maturities within the next few months.

Downside scenario

We could lower the ratings on SBB if the company fails to execute sufficient asset disposals or otherwise secure sufficient funding for its short-term liquidity needs. We could also downgrade the company further if there were additional unexpected events, materially constraining the credit profile or liquidity of SBB or the possibility of a distressed exchange, as defined by S&P Global Ratings, were to arise.

Upside scenario

We could affirm the ratings on SBB if the company managed to proceed with sufficient disposals or raised additional capital and restore its liquidity.

Company Description

SBB is one of the largest listed real estate companies in the Nordics. It had a portfolio value of about SEK130 billion (about €11 billion) on June 30, 2023. SBB mainly invests in community service properties (67% of total portfolio value) and Swedish regulated residential properties (28%). In addition, the company owns other properties (5%), mainly commercial assets with identified development potential, for which it seeks to obtain building rights, to be subsequently

sold. The portfolio is in the Nordic region, with 72% in Sweden. In addition, SBB has operations in Norway (18%), Finland (8%), and Denmark (2%).

Liquidity

We revised SBB's liquidity to weak from less than adequate. Our short-term rating on the company remains 'B'. We estimate that liquidity sources will be insufficient to cover the likely uses by less than 1x for the 12 months from June 30, 2023.

Principal liquidity sources as of June 30, 2023, include:

- SEK1.6 billion of available unrestricted and unpledged cash on the balance sheet;
- SEK2.5 billion of undrawn committed credit lines, maturing in more than 12 months;
- Our forecast of cash funds from operations of about SEK2 billion;
- Receivables of about SEK2.36 billion related to the announced issuance of preference shares at its subsidiary; and
- Committed asset disposal proceeds of about SEK795 million, including the remaining cash proceeds from the Brookfield transaction of about SEK400 million.

Principal liquidity uses as of June 30, 2023, include:

- SEK14.5 billion of short-term debt maturities, including contractual debt amortization and outstanding commercial papers;
- About SEK200 million of committed capital expenditure; and
- About SEK2 billion of cash dividends following the extraordinary general meeting on June 14, 2023.

ESG credit indicators: E-2, S-2, G-5

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, 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: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

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- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

Related Research

- Samhallsbyggnadsbolaget Downgraded To 'BB-' On Business Uncertainty And Tightening Liquidity; On CreditWatch Negative, June 7, 2023
- Samhallsbyggnadsbolaget Downgraded To 'BB+' On Continuously High Leverage And Tightening Liquidity; Outlook Negative, May 8, 2023

Ratings List

Downgraded

	To	From
Samhallsbyggnadsbolaget i Norden AB (publ)		
Issuer Credit Rating	CCC+/Negative/C	BB-/Watch Neg/B
Senior Unsecured	CCC+	BB-/Watch Neg
Recovery Rating	3(65%)	3(65%)
Subordinated	CC	B-/Watch Neg
Commercial Paper	C	B/Watch Neg
SBB Treasury OYJ		
Senior Unsecured	CCC+	BB-/Watch Neg
Recovery Rating	3(65%)	3(65%)

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