S&P Global
Ratings

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Research Update:

Samhallsbyggnadsbolaget Downgraded To 'BB+' On Continuously High Leverage And Tightening Liquidity; Outlook Negative

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Rating Action Overview

- Swedish landlord Samhallsbyggnadsbolaget i Norden AB´s (SBB) credit metrics did not improve sufficiently in first-quarter 2023 after it closed the transaction with Brookfield, resulting in S&P Global Ratings-adjusted debt to debt plus equity remaining at a high 59.9% and EBITDA interest coverage falling to 2.1x (rolling 12 months [RTM] figure).
- The company´s committed credit facilities halved in the first quarter, with significant short-term debt maturities of over Swedish krona (SEK) 14 billion for the next 12 months, increasing concerns on SBB´s liquidity position.
- Despite robust operating performance and our expectations that the company remains committed to reducing leverage over the near term, we no longer believe SBB will maintain S&P Global Ratings-adjusted debt to debt plus equity of well below 60% over the next 12 months, with EBITDA interest coverage falling to about 2x by year end.
- Consequently, we lowered our long- and short-term issuer credit ratings on SBB to 'BB+/B' from 'BBB-/A-3', our issue ratings on its senior unsecured debt to 'BB+' from 'BBB-', and our issue ratings on the subordinated hybrid bonds to 'B+' from 'BB'. We also assigned a recovery rating of '3' to the senior unsecured debt.
- The negative outlook reflects the possibility of a downgrade by one notch over the next six to 12 months if SBB does not secure sufficient funding sources to meet upcoming short-term financial obligations in the next few quarters, which would harm its liquidity position.

Rating Action Rationale

SBB´s credit metrics remained elevated following the first-quarter 2023 results publication, despite the receipt of SEK8.7 billion from Brookfield. The results showed S&P Global Ratings-adjusted debt to debt plus equity remained high at 59.9% versus 63.3% at year-end 2022. Although the company reduced leverage following the sale of a 51% equity stake in EduCo, having received about SEK8.7 billion from Brookfield (with a further SEK500 million to be received in second-quarter 2023), leverage reduction was partially offset by about 2% of negative property valuations over the quarter. We take into account the company´s commitment to deleverage, its intention to undertake a rights issue of SEK2.637 billion, and potential further asset disposals of SEK6 billion in the next couple of months. However, we believe that SBB will not be able to reduce debt to debt plus equity to well below 60%. In addition, higher refinancing costs will likely weigh negatively on the company´s EBITDA interest coverage. At March 31, 2023, the ratio stood at 2.1x (RTM), down from 2.4x at year-end 2022 and 2.9x at Sept. 30, 2022. We understand that the company aims to refinance short-term debt--the more expensive debt in its capital structure--which should limit the effect on its overall interest costs. That said, we expect its total cost of debt to continue rising to about 2.5%-3.0% this year versus 2.29% at March 31, 2023, and 2.12% at Dec. 31, 2022. The company has about 85% of its debt exposure at fixed or hedged interest rates, but we note that about 41% of this debt will mature within the next 24 months. Therefore, we expect EBITDA interest coverage to remain close to 2x over the next 12 months.

SBB's liquidity has tightened with reduced availability of undrawn credit facilities and a higher amount of short term debt maturities in the next 12 months, but we understand it is in negotiations to secure several liquidity sources. At March 31, 2023, SBB's unrestricted and unpledged cash on the balance sheet amounted to about SEK4.3 billion. The company´s committed undrawn credit lines reduced significantly to about SEK2.6 billion versus about SEK4.5 billion at year-end 2022. We understand that--as a result of the Brookfield transaction--credit lines were partially converted into term loans, resulting in a lower amount of committed lines to cover obligations. The company's short-term debt maturities stood at SEK14.3 billion (including commercial paper and the €700 million senior unsecured bond, due February 2024) at March 31, 2023, versus SEK10.5 billion at year-end 2022. We understand that the company intends to complete a rights issue of SEK2.637 billion, sign additional sales with an annual disposal target of SEK6 billion, and increase its undrawn committed credit facilities. Therefore, we maintained our liquidity assessment at adequate, based on our temporary calculation for the next six months and its sound relationships with banks. We will monitor its success in obtaining sufficient funding over the next couple of months and may review our rating if the company cannot secure sufficient liquidity sources to cover upcoming needs well in advance.

SBB received SEK8.7 billion (out of SEK9.2 billion) of proceeds in the first quarter after selling a 49% stake in newly created subsidiary EduCo to an open-ended core infrastructure fund of Brookfield. Under the deal, announced in October 2022, SBB will retain the remaining 51% stake. The transferred portfolio comprised educational assets worth about SEK43 billion (about 33% of SBB´s total portfolio size). EduCo's debt structure comprises about SEK6.9 billion of outstanding external bank loans attached to the transferred assets and a SEK14.5 billion intercompany bank loan provided by SBB, carrying a fixed rate of 3% with a six-year tenor. Out of the SEK9.2 billion sold minority interest, we understand that the company has received SEK8.7 billion in the year to date and that the remaining SEK500 million will be received in second-quarter 2023. SBB has used the majority of the proceeds to repay outstanding debt, mainly its bridge facility of €750 million due in 2024, which was used to buy back senior unsecured bonds and hybrid bonds for a cash consideration of €631 million in principal. Therefore, SBB´s gross debt decreased to SEK83.6 billion at March 31, 2023, from about SEK89.3 billion at year-end 2022. Although we view the transaction as positive for SBB's deleveraging plans, we believe it adds complexity to the corporate structure given the company does not have full access to EduCo's cash flows while it fully consolidates it. Due to the lack of available financial accounts for EduCo at this stage, and in line with International Financial Reporting Standards, we will keep consolidating EduCo in SBB's accounts. However, we recognize that SBB will no longer accrue the full benefits of EduCo´s cash flows and we anticipate SBB´s credit metrics will be slightly weaker if proportionally consolidated, given EduCo's lower leverage. That said, SBB will retain control over the subsidiary and manage the assets.

We have applied a negative comparable rating analysis and financial policy modifier, given SBB's high transaction level and insufficient deleveraging progress. SBB's negative standing in our comparable ratings analysis 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 over the past few years with a series of transformative acquisitions and, particularly over the past 12-24 months, undertook substantial acquisitions and disposals. This limits transparency on actual earnings capacity and makes it more challenging to track progress. In addition, the rating reflects the company´s slow and limited path to deleveraging over the past few years versus anticipated improvements, occasionally hit by unexpected events, or increased shareholder distributions.

We expect operating fundamentals to remain solid for SBB´s properties, thanks to good demand for community service and residential assets in its markets. For the first three months of 2023, the company reported strong positive like-for-like rental income growth of 9.9% as well as a high and slightly improving occupancy ratio of 95.5%, from 94.3% at year-end 2022, for its portfolio. Overall, SBB´s portfolio is spread across major Nordic university cities and capitals with healthy population growth, solid demand, and limited new supply. Consequently, we expect positive like-for-like rental growth of 5.0%-6.0% over the next 12 months and about 2.5%-3.0% in the following 12 months, as well as sustained high occupancy rates of about 95%. Furthermore, we anticipate that its EBITDA margin will remain at about 62%-64%, benefiting from indexation-linked rental contracts and about SEK200 million-SEK350 million of annual dividends received from its joint ventures (JVs). SBB also plans to reduce its capital expenditure (capex) and limit exposure to development and renovation activities. We forecast that capex will decline to SEK2 billion-SEK3 billion annually in 2023 and 2024 from SEK4.8 billion in 2022.

Based on SBB's audited annual accounts for 2022, we have updated our adjustments to its credit metrics.

These include.

- Accessible cash and liquid investments: SBB started to report restricted cash for the first time in its 2022 financial accounts, which we deducted from the company´s available accessible cash and liquid investments, the latter being netted from our debt figure.
- Hybrid capital instruments: After a review of the bond documentation for the hybrid instrument issued by operating subsidiary Offentliga Hus in 2021, with an outstanding amount of SEK297.5 million at year-end 2022, we view the instrument as 100% debt with 100% of its coupon payments allocated to interest expense. The amendment affects our adjustments to debt, equity, and interest expense.
- Capitalized interest: The company reported capitalized interest for investment in the property portfolio of SEK136 million in 2022. We add those types of costs to our adjusted interest expenses, in line with our criteria.

The above adjustments result in an increase in reported debt by SEK1.2 billion and an increase in interest expense by SEK150 million. The effect of this is immaterial for the 2022 ratios.

Outlook

The negative outlook reflects the possibility of a downgrade by one notch over the next six to 12 months if SBB does not secure sufficient funding sources to meet upcoming short-term financial obligations in the next few quarters, which would harm its liquidity position.

In addition, a deterioration of its credit metrics beyond our forecast could also lead to a downgrade.

Downside scenario

We could lower the rating if SBB:

- Is unable to secure sufficient funding sources in the next couple of quarters to sustainably cover its short-term financial obligations by at least 1.2x over a 12-month horizon. This could be due to failure to issue the planned equity of SEK2.637 billion, make additional sizable sales, and enhance its committed undrawn credit facilities.
- Cannot maintain S&P Global Ratings-adjusted debt to debt plus equity below 60%. This could occur if the company experiences higher-than-anticipated asset devaluations or further write downs; or
- Fails to sustain EBITDA interest coverage above 1.8x, or its debt to annualized EBITDA materially differs from our forecast.

Upside scenario

We could revise the outlook to stable if SBB sustainably:

- Improves its liquidity situation, such that the company secures sufficient liquidity sources to meet its financial obligations well ahead of maturities and maintains solid liquidity headroom at all times;
- Maintains debt to debt plus equity below 60%;
- Preserves EBITDA interest coverage above 1.8x; and
- Keeps debt to EBITDA within our base-case forecast levels, with the company maintaining a sizable portfolio of resilient asset classes in favorable locations.

Company Description

SBB is one of the largest listed real estate companies in the Nordics and had a portfolio value of SEK134.4 billion (about €12 billion) at March 31, 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 sold afterward. The portfolio is in the Nordic region, with 73% in Sweden. In addition, SBB has operations in Norway (18%), Finland (8%), and Denmark (1%).

Our Base-Case Scenario

Assumptions

- Real GDP growth in Sweden of negative 0.3% and positive 1.1% for 2023 and 2024 and consumer price index growth of 7.0% and 3.5%, respectively.
- Annual like-for-like rental income growth of at least 5%-6% for SBB's properties in 2023 and 2.5%-3.0% in 2024, the latter on the back of slowing inflation.
- Stable occupancy rates of about 95%, reflecting ongoing solid demand for SBB´s assets as well as its long lease terms.
- EBITDA margins are broadly stable at 2022 levels of about 62%-64% for the next 12-24 months, with about SEK300 million-SEK400 million of dividends received from associated companies or JVs in 2023 and SEK200 million-SEK300 million in 2024.
- Like-for-like overall portfolio devaluations of 5%-6% for 2023 and further low-single-digit percentage devaluation for 2024, mainly reflecting the expected rise in interest rates and corresponding yield expansion.
- Annual capex of about SEK2 billion-SEK3 billion in the next 12-24 months, including development projects (a mix of JVs, turnkey business, and direct development).
- Some asset disposals of about SEK4 billion in 2023 and a further SEK3 billion annually in the following years, in line with the company´s announced strategy to be a net seller.
- About a SEK2.63 billion rights issue, as planned and announced by the company, although we understand this is not fully committed yet.
- Cash common dividends of about SEK2 billion in 2023 (excluding hybrid coupon payments), assuming about 30%-40% of shareholders opt for the proposed dividend reinvestment plan, and about SEK2 billion-SEK3 billion of cash dividends in the years after.
- Average cost of debt increases to about 2.5%-3.0% in full-year 2023 from 2.29% in the first quarter, excluding hybrid instruments. That said, we understand SBB will refinance more expensive debt and assume the increase in average cost of debt is moderate.

Key metrics

- Adjusted debt to debt plus equity at close to 60% over the next 12-24 months.
- EBITDA interest coverage falling to about 2x over the same period.
- Debt to EBITDA of 17x-18x, including the full-year effect of 2022 net acquisitions and benefiting from increased rental income due to inflation.

Liquidity

We assess SBB's liquidity as adequate, based on our temporary calculation for the next six months and the company´s good access to bank financing. Our short-term rating on the company is 'B'. We anticipate that liquidity sources will likely cover uses more than 1.2x for the six months from March 31, 2023. We assume that SBB will continue to enhance its committed undrawn credit lines as per the company´s strategy. We exclude from our analysis the planned rights issue, or disposals and acquisitions, which are not committed at this stage.

Principal liquidity sources as of March 31, 2023 include:

- SEK4.3 billion of available unrestricted and unpledged cash on the balance sheet;
- SEK2.6 billion of undrawn committed credit lines, maturing in more than 12 months;
- Our forecast of cash funds from operations of about SEK3 billion;
- Signed loans of about SEK2.4 billion post the reporting date; and
- Committed asset disposals of about SEK2.1 billion, including the remaining cash proceeds from the Brookfield transaction of about SEK500 million.

Principal liquidity uses as of March 31, 2023 include:

- SEK3 billion-SEK5 billion of short-term debt maturities, including contractual debt amortization and outstanding commercial papers;
- About SEK100 million of committed capex; and
- About SEK2 billion of cash dividends, mainly related to common dividends and class-D shares.

Covenants

We understand that SBB needs to comply with the covenants for its existing bond issuances and credit lines.

We understand that the headroom under these covenants is adequate, at more than 10%, and we expect the company to maintain sufficient headroom going forward.

Issue Ratings - Subordination Risk Analysis

Capital structure

In first-quarter 2023, SBB's capital structure comprised interest-bearing liabilities amounting to SEK83.56 billion—comprising traditional bank loans (about SEK28.48 billion), senior unsecured bonds (SEK52.1 billon), and commercial paper (SEK2.457 billion)—as well as SEK16.5 billion of hybrid bonds. At March 31, 2023, the proportion of interest-bearing liabilities with fixed or hedged interest was 85%, with the average debt maturity at four years.

Analytical conclusions

We rate SBB's senior unsecured bonds in line with the 'BB+' issuer credit rating, performing our recovery analysis as described below. The company´s commercial paper program is rated 'B'.

The subordinated hybrid notes are rated 'B+', three notches below the issuer credit rating, including two notches for subordination and one notch for optional deferability, in line with our criteria. We maintain our assessment of intermediate equity content (50% equity and 50% debt) for the three rated hybrid bonds.

Issue Ratings - Recovery Analysis

Key analytical factors

- The issue rating on SBB's senior unsecured notes with a combined nominal value of €3.9 billion (of which €1.75 billion are issued under SBB holding and €2.150 billion are issued under SBB Treasury OYI) is 'BB+', in line with the issuer credit rating.
- The bondholders will benefit from a valuable asset base, mostly consisting of stabilized income-producing investment properties.
- Although the numerical recovery outcome is at close to 95%, we cap the recovery rating on the notes at '3', in line with our criteria. This is due to a combination of reasons encompassing the notes' unsecured nature, the risk that additional prior-ranking debt could be raised on the path to default considering the challenging debt capital markets environment and SBB's amount of debt maturities over the next 12 to 24 months, the current volatile valuation environment for the real estate industry, and risks on the accessibility of assets at EduCo JV in a hypothetical default.
- Our recovery prospects are also constrained by the unsecured nature of the debt instrument and its contractual subordination to the current amount of secured debt.
- In our hypothetical default scenario assumed for 2028, we envisage a severe macroeconomic downturn in Sweden, Finland, and Norway, resulting in market depression and exacerbated competitive pressures.
- For recovery purposes, we only give value to the 51% stake that SBB owns in the nonguarantor EduCo JV, which holds its educational portfolio of assets, worth about SEK43 billion.
- We value the group as a going concern. We use a discrete asset value approach to take into consideration the stressed value of SBB's yielding properties as well as building rights. Recovery prospects for the proposed senior unsecured notes are very sensitive to a small change in the amount of senior secured debt or any other priority debt outstanding at default.
- The bond documentation includes limitations on indebtedness--a maximum debt to asset ratio of 65%--and a limitation on prior-ranking debt, with secured debt to total assets restricted to a maximum of 45%.

Simulated default assumptions

- Year of default: 2028
- Jurisdiction: Sweden

Simplified waterfall

- Gross enterprise value (EV) at emergence including the residual amount of the 51% equity stake in EduCo: SEK79.4 billion
- Net EV at emergence after administrative costs: SEK75.4 billion
- Estimated priority debt (credit lines, mortgages, and other secured debt): About SEK27,5 billion

- Net EV available to senior unsecured bondholders: SEK47.9 billion
- Senior unsecured debt claims: SEK51.3 billion
- Recovery Rating: 3
- Recovery expectation: 50%-70% (rounded estimate: 65%)

*All debt amounts include six months of prepetition interest and assume 85% of the RCF and credit lines are drawn on default (SBB's credit lines totaled about SEK8.1 billion as of March 31, 2023).

Ratings Score Snapshot

Issuer Credit Rating	BB+/Negative/B
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 (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-1 notch)
Liquidity	Adequate (neutral)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)

ESG credit indicators: E-2, S-2, G-4

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
- Criteria | Corporates | General: Corporate Methodology , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- General Criteria: Methodology: Industry Risk , 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

- Swedish Property Company SBB Affirmed At 'BBB-' On Announced Strategic Deal With Brookfield; Outlook Remains Negative, Dec. 6, 2022
- Samhällsbyggnadsbolaget's Third-Quarter Results Tighten Rating Headroom, Oct 28, 2022

Ratings List

Downgraded; New Recovery Rating

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