



RATING ACTION COMMENTARY

Fitch Downgrades SBB's Senior Unsecured Rating to 'CCC+'; Maintains Rating Watch Negatives

Tue 19 Mar, 2024 - 9:10 AM ET

Fitch Ratings - Frankfurt am Main - 19 Mar 2024: Fitch Ratings has downgraded Swedish property company SBB - Samhällsbyggnadsbolaget i Norden AB's (SBB) senior unsecured debt rating to 'CCC+' from 'B'. Its Recovery Rating was revised to 'RR4' from 'RR2'. Other SBB ratings were unaffected and all ratings remain on Rating Watch Negative (RWN). A full list of rating actions is below.

This senior unsecured rating downgrade reflects SBB's shrinking unencumbered investment property pool, signifying lower recoveries available to unsecured debtholders. Using figures after end-December 2023 disclosures and updating these following yesterday's offer for SEK2.5 billion of unsecured bonds (potential prepayments) and assuming SBB's Castl lake joint venture (JV) created encumbered investment property assets, the Recovery Rating would be 'RR4'. Fitch assumes that some of the Castl lake net proceeds totaling SEK5.2 billion are being reserved for SBB's June 2024 cash dividend.

Liquidity remains tight. Assuming no cash dividend in June 2024 nor refinancing of secured debt, Fitch forecasts additional liquidity will be required in 3Q24.

KEY RATING DRIVERS

Shrinking Unencumbered Investment Property Pool: SBB's unencumbered investment property asset pool has shrunk considerably in the last six months as the company has completed a number of disposals, the largest of which was Nordiq AB. This shrinking pool of relevant assets signifies lower recoveries for unsecured creditors in a liquidation. Updating figures after end-December 2023 disclosures, Fitch calculates SBB's unsecured debt at about SEK40.6 billion (end-2023: SEK43.5 billion) against unencumbered investment properties of SEK29.8 billion (end-2023: SEK31.6 billion).

After also including the Castlelake proceeds and today's tender offer potentially prepaying SEK2.5 billion on unsecured bonds Fitch calculates SBB's unsecured debt could be SEK38.2 billion against unencumbered investment properties of SEK20.5 billion. We assume SBB will not prepay tendered hybrids.

Unreceptive Bond Market: SBB does not have capital-market access to refinance its unsecured bonds. This is due to several factors, including a bondholder contesting a covenant breach, the merits of which are contentious and has now proceeded to legal process but will take time to reach a judgement; creditors' concerns about real estate values and their effect on SBB's residential and community service portfolio when monetised as a 'distressed' seller; and refinance risk. Without improved debt-market access, we expect SBB to sell assets to meet debt maturities.

New Asset-Backed Transaction: In February 2024, SBB announced a JV with Castlelake, LP, called SBB Infrastructure AB, backed by about SEK9.4 billion of its community service assets. Although details of the transaction are still unclear, Fitch believes it also includes a loan component. SBB Infrastructure will acquire SEK5.7 billion worth of community service assets from SBB while an additional SEK3.7 billion of (we assume previously unencumbered) assets will be provided by SBB as collateral for the loan. Until details are clear (hence the above assumptions) the senior unsecured rating remains on RWN.

The Castlelake transaction underscores SBB's difficulty in assessing the unsecured debt market for liquidity. As SBB enters into this type of transactions, the unencumbered investment property pool will continue to shrink until, ultimately, protection from the group's secured debt/consolidated total assets covenant is triggered (2023:18% versus covenanted 45%).

Ongoing Disposal Plans: SBB continues to undertake asset disposals but execution risk remains high. In its 2023 results, SBB again announced plans to sell its residential portfolio, thus raising capital from an external equity contribution in 2024 (including an IPO or strategic partnership). Proceeds would be used to reduce leverage and repay debt. Income-producing assets are available to sell, at a price. The Fitch-calculated loan-to-value (gross debt/investment property assets) at end-2023 was 84%.

DERIVATION SUMMARY

The lower-yielding nature of SBB's residential rental portfolio and longer lease length than peers' (from both community service assets and given the average tenure of residential assets), plus its portfolio mix, allow SBB more leverage headroom and lower interest cover

than that of both commercial property-orientated Swedish peers and EMEA commercial property peers.

Fitch views SBB's real estate portfolio as stable, due to the strength of Swedish residential properties with regulated below-open market rents and the stable government-entity tenant base with longer-term leases of community service properties. This is tempered by the regional location of some assets within SBB's portfolio. Its portfolio 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.

See our previous rating action commentaries for peer analysis justifying the investment-grade quality of SBB's property portfolio before we downgraded its ratings for heightened refinancing risk.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Disposals of primarily community service properties during 2023 amounting to SEK6 billion
- Moderate 2.5%-4% rental growth in 2023-2026, driven by CPI indexation and moderate inflation
- Around SEK1 billion in residential and community service refurbishment capex per year until our forecast horizon of 2027, with a net 4%-6% income return on spend
- No acquisitions during 2024 - 2027
- Building-rights profits and disposal proceeds amounting to SEK0.8 billion-SEK1 billion per year in cash flow for the next four years

RECOVERY ANALYSIS

Our recovery analysis assumes that SBB would be liquidated rather than restructured as a going concern in a default.

Recoveries are based on the end-December 2023 independent valuation of the investment property portfolio. Fitch has deducted disclosed encumbered assets to arrive at a total of

around SEK29.8 billion of unencumbered investment property assets. Fitch applies a standard 20% discount to these values. We assume no cash is available for recoveries.

After deducting a standard 10% for administrative claims, in the debt hierarchy we deducted the recent SEK2.4 billion SBB Residential Property AB preference shares, which rank ahead of SBB's unsecured creditors. Therefore the total amount of assets we assume available to unsecured creditors is around SEK19.1 billion. We have updated outstanding debt after recent financings, such as use of cash to repay remaining (untendered) 1Q24 maturing bonds.

Fitch's principal waterfall analysis generates a ranked recovery for senior unsecured debt of 'RR4' (a waterfall generated recovery computation output percentage of 47%) based on current metrics and assumptions. The 'RR4' indicates a 'CCC+' unsecured debt instrument rating.

Updating this for the Castlake transaction and today's tender offer assumptions, the total amount of assets available to unsecured creditors after Fitch's standard 20% discount is around SEK16.4 billion relative to unsecured debt of SEK38.2 billion. Fitch's principal waterfall analysis generates a ranked recovery for senior unsecured debt of 'RR4' (32%). The 'RR4' indicates a 'CCC+' unsecured debt instrument rating.

Given the structural subordination of SBB's hybrids, we estimate a ranked recovery of 'RR6' with 0% expected recoveries. The 'RR6' band indicates a 'CCC-' instrument rating, two notches below SBB's IDR.

RATING SENSITIVITIES

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

- Evidence that refinancing risk has eased, including improved capital-market receptivity to SBB
- Successful disposal proceeds used to prepay 2025 and 2026 debt maturities, and increasing liquidity

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

- Lack of progress in refinancing secured bank funding

- Actions pointing to a widespread potential renegotiation of debt terms and conditions, including any material reduction in lenders' terms sought to avoid a default
- Further shrinking of the unencumbered investment property portfolio relative to unsecured debt would lead to a further downgrade of the senior unsecured rating

LIQUIDITY AND DEBT STRUCTURE

Tight Liquidity: SBB's available liquidity at end-2023 was SEK4.1 billion of cash. The previous SEK3.5 billion of available revolving credit facilities are not available for drawdown. Post-3Q23 SBB received Nordiqus disposal proceeds totaling SEK8 billion. The November 2023 tender offer prepaid SEK4.7 billion of its 1Q24 debt obligations while the remaining SEK1.8 billion was paid in January 2024.

Together with other disposal receipts and outflows, Fitch calculates a potential liquidity shortfall during 3Q24, assuming that banks do not roll over their secured facilities, and the 2022 postponed dividend is not paid in cash. This shortfall could be post-3Q24 if banks roll over their secured exposures. SBB is therefore reliant on further disposal proceeds to refinance debt including 1Q25 scheduled bond maturities of SEK5.3 billion.

After including Fitch's Castlake assumptions, today's tender offer potentially prepaying SEK2.5 billion of near-term unsecured bonds, the payment of June 2024 cash dividend payment (and hybrid deferred interest), and assuming secured financings are not refinanced, a liquidity shortfall is still likely in 3Q24 ahead of its remaining untendered bonds in 1Q25.

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

SBB has an ESG Relevance Score of '4' for Governance Structure to reflect previous key person risk (the previous CEO) and continuing different voting rights among shareholders affording greater voting rights to the key person.

SBB has an ESG Relevance Score '4' for Financial Transparency, reflecting an ongoing investigation by the Swedish authorities into application of accounting standards and disclosures.

Both these considerations have a negative impact on the credit profile, and are relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

<https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	RECOVERY ↕	PRIOR ↕
SBB - Samhallsbyggnadsbolaget i Norden AB			
senior unsecured	LT CCC+ Rating Watch Negative Downgrade	RR4	B Rating Watch Negative
SBB Treasury Oyj			
senior unsecured	LT CCC+ Rating Watch Negative Downgrade	RR4	B Rating Watch Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 13 Oct 2023\) \(including rating assumption sensitivity\)](#)

[Corporate Rating Criteria \(pub. 03 Nov 2023\) \(including rating assumption sensitivity\)](#)

[Sector Navigators – Addendum to the Corporate Rating Criteria \(pub. 03 Nov 2023\)](#)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

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SBB - Samhallsbyggnadsbolaget i Norden AB

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