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Fitch Affirms SBB at 'BBB-' on EduCo sale; Outlook Positive

Fitch Ratings - Frankfurt am Main - 02 Dec 2022: Fitch Ratings has affirmed Swedish property company Samhallsbyggnadsbolaget i Norden AB's (SBB) Long-Term Issuer Default (IDR) at 'BBB-' with a Positive Outlook. A full list of rating actions is below.

The rating action follows the announcement that SBB has sold a 49% stake in EduCo, a newly-formed JV holding SEK44.9 billion of SBB's Nordic public education properties, to Brookfield for SEK9.2 billion in cash plus additional proceeds if certain targets are met. SBB will use the EduCo proceeds for deleveraging, repaying a bridge loan previously used to buy back senior and hybrid bonds in November 2022, and repaying other debt.

The Positive Outlook reflects Fitch's expectation of improvements in SBB's financial profile as it completes planned disposals and benefits from inflation-linked rent increases and moderates its pace of acquisitions. Fitch forecasts SBB will deleverage to 12.4x net debt/EBITDA in 2023 and to 11.4x in 2024, while improving interest cover to above 3x in 2024. This includes our assumptions of refinancing SBB's debt at higher rates.

Key Rating Drivers

EduCo Disposal Aid Deleveraging: As part of the EduCo transaction, SBB is contributing SEK44.9 billion of public education properties and a SEK14.5 billion up to six-year shareholder loan (at 3% interest cost) to EduCo. SBB will retain a 51% ownership share and receive SEK9.2 billion as a cash consideration from Brookfield, which will aid deleveraging. SBB will continue to manage EduCo's assets in return for a management fee (1.8% of net operating income) and interest income under the shareholder loan. The transaction will complete in two stages at the latest in 1Q23 and 2Q23, respectively.

Amasten Distribution Reduces Residential: SBB has also announced plans to distribute a SEK18 billion residential portfolio, the Amasten Fastighets AB portfolio, part of which SBB recently acquired, together with attached secured debt to SBB's shareholders. In its rating case, Fitch assumed the distribution will take place with corresponding loss of rental income and residential assets. SBB will not retain any shares in the Amasten entity following the distribution. The formal decision to go ahead will be taken in an extraordinary general meeting on 21 December 2022.

Post-Transaction Portfolio: SBB's investment property portfolio was SEK154.5 billion at end-3Q22 comprising community service (elderly care/LSS (disabled) housing, healthcare) and residential properties. SBB will continue to fully consolidate EduCo following the transaction, while at share SBB's

portfolio will be reduced by approximately SEK40 billion. SBB benefits from inflation-indexed, government-linked contracts with long average remaining lease length (3Q22: 11 years) and the stability of regulated residential-for-rent.

Impact on Rating Sensitivities: Fitch has adjusted SBB's net debt/EBITDA upgrade and downgrade sensitivities by 0.5x to reflect the expected resultant business mix with a lower share of residential-for-rent following the proposed Amasten distribution. In the event of EduCo refinancing SBB's SEK14.5 billion shareholder loan with external debt and SBB using these proceeds to reduce debt, SBB's deleveraging would be accelerated. When this refinancing happens, Fitch intends to adjust SBB's leverage rating sensitivities to reflect the impact of a more subordinated dividend income stream from EduCo within SBB's EBITDA.

Reduced Refinancing Risk: The announced disposals improve SBB's liquidity position by SEK11.2 billion (pro forma for SEK2.0 billion in disposals taken place after end-3Q22) to SEK16.8 billion plus SEK7.9 billion in unutilised credit facilities. Of the SEK16.8 billion, approximately SEK5.5 billion will be used to repay the bridge facility that was drawn to buy back senior and hybrid bonds at a discounted price in November 2022. The acquired senior bonds had maturities in 2023, 2024 and 2025.

Derivation Summary

With 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), and its portfolio mix, Fitch has allowed SBB more leverage headroom and lower interest cover than (i) commercial property-orientated Swedish peers; and (ii) EMEA commercial property peers that underpin our EMEA REIT Navigator mid-point guidelines.

Fitch views SBB's portfolio as stable, due to the strength of Swedish residential properties with regulated below-open market rents and community service properties' stable tenant base with longer term leases. 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 the market fundamentals.

Assura plc (A-/Stable) builds and owns modern general practitioners' (doctors) facilities in the UK, with approved rents indirectly paid by the state National Health Service and similar 11.7 years weighted average unexpired lease term (WAULT). Its portfolio was much smaller than SBB's at GBP2.6 billion. Reflecting Assura's community service activities, a 4.6% net initial yield (SBB: 3.8%), 99% occupancy rate, and specific-use assets, the company's downgrade rating sensitivity to 'BBB+' includes net debt/EBITDA greater than 9x, compared with SBB's blended upgrade metric to 'BBB' below 12x net debt/EBITDA. In part, this acknowledges the wider diversity of SBB's larger portfolio, including the mix of residential rental exposure, and lower Swedish interest rate environment (as reflected in tighter property yields). Net interest cover (NIC) is more difficult to compare, as the companies have different interest rate environments. Assura's NIC is markedly higher than SBB's at 4x.

The smaller, but community service-akin Civitas Social Housing PLC and Triple Point Social Housing

REIT PLC (both A-/Stable) have the same 'BBB+' leverage downgrade rating sensitivity as Assura for their long WAULT, low vacancy rate, and special needs accommodation that also has a government rental income covenant (sourcing housing benefit). Annington Limited (BBB/Stable) is less comparable with SBB as it has a direct UK Ministry of Defence rental covenant for its military housing portfolio with no void or maintenance cost risks.

These peers have not had SBB's significant merger and acquisition activity.

Key Assumptions

- Completion of the EduCo disposal and Amasten distribution during 2023.
- Moderate rental growth driven by higher CPI indexation.
- Around SEK1 billion in residential and community service refurbishment capex per year, which has a net 5%-6% income return on spend.
- A moderate pace of asset rotation following completion of announced transactions.
- Building rights profits and disposals amounting to SEK1.5 billion per year in the cash flow for each of the next four years.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Net debt/EBITDA of less than 12x based on the current portfolio mix of around 20% residential by EBITDA
- EBITDA net interest cover greater than 3.0x
- Unencumbered investment property assets/unsecured debt above 2.0x
- Weighted average debt maturity above five years

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Net debt/EBITDA greater than 13.5x
- EBITDA net interest cover below 2.0x
- 12-month liquidity score below 1.0x

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the

99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

Liquidity and Debt Structure

Adequate Liquidity: At end-3Q22, SBB had SEK4.9 billion in readily available cash and SEK7.9 billion of undrawn credit facilities. This compared with SEK8.5 billion in bond and bank debt and SEK2.5 billion in commercial paper maturing within 12 months. Another SEK18 billion of debt was maturing within 24 months. SBB's average interest cost was 1.89% at end-3Q22, excluding hybrids.

SBB's liquidity has improved in 4Q22 as the EduCo transaction will add another SEK9.2 billion in cash, plus an additional SEK2 billion from other disposals after end-3Q22. These proceeds will partly be used to repay SEK5.5 billion in drawings under SBB's bridge facility. Remaining near-term maturing bonds following SBB's bond buy-back amount to SEK0.5 billion in 2022, SEK4 billion in 2023 and SEK7.2 billion in 2024 in addition to maturing bank debt.

Issuer Profile

SBB is a Nordic property owner specialising in community service and residential properties.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
SBB - Samhallsbyggnadsförbundet i Norden AB	ST DR BBB- 		Affirmed	BBB- 
	ST IDR		F3	F3
	• subordinated		BB	BB
	• senior unsecured	LT	BBB-	BBB-
	• senior unsecured	ST	F3	F3
SBB Treasury Oyj				

ENTITY/DEBT	RATING	RECOVERY	PRIOR
• senior unsecured ^{LT}	BBB-	Affirmed	BBB-

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	◐	

Applicable Criteria

[Corporate Hybrids Treatment and Notching Criteria \(pub.12 Nov 2020\)](#)

[Corporate Rating Criteria \(pub.28 Oct 2022\) \(including rating assumption sensitivity\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub.09 Apr 2021\) \(including rating assumption sensitivity\)](#)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub.28 Oct 2022\)](#)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

SBB - Samhallsbyggnadsbolaget i Norden AB EU Issued, UK Endorsed

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