

Research Update:

# Swedish Property Company Samhallsbyggnadsbolaget Outlook Revised To Negative From Stable; 'BBB-/A-3' Ratings Affirmed

July 8, 2022

## Rating Action Overview

- Following recent accounting concerns in the markets related to debt reconciliation in its financial statements, Samhallsbyggnadsbolaget (SBB) published an alternative cash flow statement on a net basis in line with IFRS, independently reviewed by auditor PricewaterhouseCoopers (PwC).
- We understand the revised cash flow statement reconciles the debt on the financial statements. However, SBB's use of format now less commonly used is considered generally as not-best practice, potentially contributing to a perceived lack of transparency in the company's communications and disclosures in our view.
- In this context, SBB's credit spreads have continued to widen beyond the sector average, posing a further threat to funding costs.
- We therefore revised our outlook on SBB to negative from stable; and affirmed our 'BBB-/A-3' long- and short-term issuer credit ratings on the company, our 'BBB-' ratings on the senior unsecured debt, and our 'BB' rating on the subordinated hybrid instruments.
- The negative outlook indicates that we could lower the ratings if challenging market conditions persist causing interest coverage ratio to drop below 2.4x or we observe further risks in management and governance.

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## Rating Action Rationale

**Following recent allegations on accounting issues, SBB published a cash flow analysis on a net basis in line with IFRS, showing reconciliation of the debt in the financial accounts.** Following concerns about SBB's cash flow statement not complying with IFRS accounting standards, the prices of the company's senior bonds fell significantly, leaving the five-year senior unsecured bond trading at below 60% of nominal value, a record low. On July 1, SBB released an alternative cash flow analysis with acquisitions presented on a net basis and a reconciliation to previously

published cash flow statements on a gross basis. This exercise showed no reconciliation error, and accordingly no material impact on the financial position, net cash flow position, or income statement. Furthermore, we understand that the complemented cash flow statements have been independently examined by PwC, while Ernst & Young remains the company's main auditors. SBB announced it will provide the cash flow analysis on a net basis in line with IFRS requirements in the future, and we understand that they also aim to strengthen their audit committee. Although in our view, these steps are positive, the alternative cash flow statement is not generally viewed as best accounting practice and therefore might have contributed to a perceived lack of transparency by the company in its disclosures.

**We expect that challenging debt capital markets will increase funding costs although balance-sheet reduction mitigates this somewhat.**

Following recent deterioration in credit market conditions, with rising interest rates and increasing credit margin reflecting higher risk in the real estate sector, SBB's credit spreads have widened significantly and above those of peers in the real estate sector. This poses a risk to funding costs and refinancing. We understand the company is targeting alternative funding sources such as increasing secured lending or private placements as these debentures can be issued at more competitive levels than current ones in the bond markets. However, we remain cautious about the amount and timing of the volume that can be raised. We anticipate that the company's cost of debt (1.24% at March 31, 2022) will rise to 1.5%-2.0% in 2022, with potentially more upward pressure in 2023. We understand SBB aims to mitigate some of the higher burden of cost of funding by reducing its debt level and so far, after first-quarter 2022, we estimate that SBB has disposed around Swedish krona (SEK) 7.4 billion of assets, with proceeds repaying short-term debt maturities. We understand the company targets another SEK5 billion of disposals before year-end, and should therefore be a net seller for 2022. Furthermore, we view the recent disposals as in line with the book value, supporting the property portfolio's valuation.

**We anticipate pressure on SBB's credit metrics, although in our view the company has sufficient liquidity buffer to address upcoming maturities.**

The outlook revision reflects our view of increasing pressure on credit ratios due to challenging market conditions. We believe SBB's credit metrics, particularly the debt service capacity ratio, might weaken toward the low end of the range commensurate with the 'BBB-' rating over the next 12-24 months. We continue to forecast S&P Global Ratings-adjusted EBITDA interest coverage will remain above 2.4x in 2022, but with potentially less headroom (it was 3.0x at first-quarter 2022) than in our base-case scenario and further pressure in 2023. However, we believe the company's cash on hand and unused committed credit lines should be enough to absorb debt maturities in the next 12 months. As of April 1, 2022, SBB faced debt maturities of SEK15.5 billion over the next 12 months, which should be sufficiently covered by its cash on balance of SEK8.9 billion and undrawn committed facilities of roughly SEK9 billion, mainly maturing in more than 24 months and bringing its ratio of liquidity sources well above 1.2x. The company has total debt maturities of SEK15 billion maturing in 12-24 months. We will continue to monitor closely how the company addresses these. We also understand that signed asset disposal amount to SEK6.8 billion at the end of June, with cash proceeds expected in the next few months that will be used for debt repayment.

## Outlook

The negative outlook indicates that there is a one-in-three chance that we would lower the ratings on SBB, especially if trading conditions remain at weak levels, affecting the company's capacity to

refinance at reasonable levels and putting pressure on its interest coverage ratio. We believe that SBB's portfolio should continue to benefit from high demand in its resilient asset segments, supporting cash flow. We conservatively expect like-for-like rental income will increase 2%-3% in the next 12-to-24 months. Over the next six months, we expect SBB to continue its asset-disposal program and exhibit financial discipline, with the debt-to-debt-plus-equity ratio remaining around 55% (including our adjustments for the hybrid capital) sustainably. Our base-case scenario also projects SBB's EBITDA interest coverage will remain above 2.4x, although with limited headroom.

## **Downside scenario**

Risk to the rating could come with further constraints on the company's management and governance structure, including unexpected events that weaken SBB's creditworthiness.

We could also lower the rating if EBITDA interest coverage falls below 2.4x or if debt to annualized EBITDA materially differs from our forecast. In addition, we would view negatively further deterioration in debt capital markets, in particular in the company's bond trading, such that it would face refinancing risks. Finally, a negative rating action would arise if SBB fails to reach its leverage targets, causing adjusted debt to debt plus equity to rise to 60% or above. This could occur if the company continues its growth strategy with debt-financing of acquisitions or operating performance is materially weaker than in our forecast.

## **Upside scenario**

An outlook revision to stable would entail the absence of unexpected negative events.

We would also revise the outlook to stable if SBB's EBITDA interest coverage stays well above 2.4x. This would imply that the company has refinanced upcoming maturities via alternative funding sources. A positive outlook revision would also be contingent upon SBB showcasing recovery in its bond trading levels, at least to levels more commensurate with the rest of the real estate industry.

Finally, a stable outlook would also assume that SBB's leverage ratios would stay well below 60% with execution of asset disposals in a timely manner to address debt well ahead of maturity if capital markets remain challenging.

## **Company Description**

SBB is one of the largest listed real estate companies in the Nordics and has a portfolio value of SEK158.9 billion (€15.2 billion) as of March 2022. It mainly invests in community service properties (60% of the total portfolio value) and Swedish regulated residential properties (35%). The company also owns other properties (5%), mainly commercial assets with identified development potential, for which it seeks to obtain building rights to sell the assets afterward. The portfolio is in the Nordic region, with 75% in Sweden. SBB also has operations in Norway (17%), Finland (7%), and Denmark (1%).

## **Environmental, Social, And Governance**

### **ESG credit indicators: To E-2, S-2, G-4; From E-2, S-2, G-3**

We believe governance factors are a negative consideration in our credit rating analysis of SBB. In

our view, the group's presentation of an alternative cash flow statement using less commonly used accounting standards is generally considered not-best practice. This in turn might have contributed to a perceived lack of transparency by the company in its disclosures.

In addition, we consider that the company relies heavily on founder and CEO Illja Batljan, who has a key role in managing and running the business. He also has 31.5% of voting rights and owned 8.1% of the share capital as of March 2022. We believe these corporate structures have a higher risk of conflicts of interest between stakeholder groups compared with other listed companies with highly diversified shareholder structures and independent management and board teams.

Environmental and social factors have an overall neutral influence on our credit rating analysis of SBB.

## Ratings Score Snapshot

Issuer Credit Rating	BBB-/Negative/A-3
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	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)

### Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Transparency and reporting

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

- Swedish Property Company Samhallsbyggnadsbolaget Outlook Revised To Stable From Positive; 'BBB-/A-3' Ratings Affirmed, June 9, 2022
- Swedish Property Company SBB 'BBB-' Rating Affirmed Following Independent Audit; Outlook Remains Positive, April 14, 2022

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Samhallsbyggnadsbolaget i Norden AB (publ)</b>		
Issuer Credit Rating	BBB-/Negative/A-3	BBB-/Stable/A-3

### Ratings Affirmed;

#### Samhallsbyggnadsbolaget i Norden AB (publ)

Senior Unsecured	BBB-
Subordinated	BB
Commercial Paper	A-3

#### SBB Treasury OYJ

Senior Unsecured	BBB-
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