Research Update:

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

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Rating Action Overview

- Following the recent weakening of credit market conditions, in particular for real estate companies, Samhällsbyggnadsbolaget i Norden's (SBB's) credit spreads have widened significantly, beyond levels of most peers, posing a risk of higher funding costs.
- Therefore, despite good operating performance and our expectations that the company could reduce leverage, we no longer believe SBB will maintain S&P Global Ratings-adjusted EBITDA interest coverage ratio sustainably above 3.0x and debt to EBITDA below 15x-16x over the next 24 months.
- We revised our outlook on SBB to stable from positive and affirmed our 'BBB-/A-3' long and short-term issue credit ratings on the company, our 'BBB-' issue rating on its senior unsecured debt, and our 'BB' rating on its subordinated hybrid bonds.
- The stable outlook indicates that SBB's properties should continue to benefit from high demand in resilient segments, including community services and regulated residential, thanks to favorable demographic trends and housing shortages in the Nordics.

Rating Action Rationale

Although credit spreads are volatile, we think new issuances in the capital market could remain substantially more expensive for SBB than in the previous two-to-three years. The outlook revision reflects our view of recent weaknesses in the credit markets, which we view as more challenging and less liquid than before, in particular for European real estate companies. Therefore, SBB's bond margins in the secondary markets have widened significantly both in absolute and relative terms beyond those of most peers over the spring, and we estimate that the yields on the three- and five-year senior unsecured bonds amount to 4.7% and 6.0%, respectively.

We anticipate that SBB's credit metrics such as S&P Global Ratings-adjusted EBITDA interest coverage will remain around 3.0x in 2022 but weaken somewhat in 2023 with higher refinancing costs. We understand the company will target alternative funding sources such as increased secured debt because these debentures can be issued at more competitive levels than currently in the bond markets. This is supported by the recent German Schuldscheindarlehen placement where the company issued two floating Euribor rate tranches with three-year and five-year maturities and a spread to maturity of 1.45% and 1.70%, respectively. We anticipate that the company's cost of debt (1.24% at March 31, 2022) will rise to 1.5%-1.6% in 2022, and with limited refinancing needs in 2022 combined with the positive impact from recent acquisitions in 2021, we believe this will continue to support its EBITDA interest coverage ratio in 2022. We anticipate some pressure on ratios in 2023 given higher debt maturities that year (Swedish krona [SEK] 14.7 billion) in less favorable funding conditions. Over the next 12-24 months, we expect S&P Global Ratings-adjusted EBITDA interest coverage to remain at 2.8x-3.0x (it was 3.0x at first-quarter 2022), lower than we had forecast (3.2x-3.4x).

We remain cautious of the transaction market, although we project further deleveraging over the next 12-24 months. Following its first-quarter report, SBB completed asset sales of SEK2.8 billion, and we understand the company plans further disposals and targets to be a net seller in 2022. Although we believe SBB is committed to reduce its property portfolio further and use proceeds to deleverage, we remain cautious of the amount the company might receive for these because the yield gap is contracting, and funding costs might exceed the pricing of their current capitalization rates on the balance sheet; there is a risk that these disposals might be postponed or reduced. Yet we conservatively assume SBB will further deleverage on already-committed or engaged asset sales, some low-single-digit positive revaluation, and positive cash flow from operations, supported by high inflation as most of the leases are index-linked. All in all, we forecast S&P Global Ratings-adjusted debt to debt plus equity to improve slightly to 52%-54% (it was 55.5% as of first-quarter 2022) in 2022 and 2023. In addition, we project debt to EBITDA to fall to 17x-18x (23.3x as of first-quarter 2022) because transactions in 2021 have not been fully captured in the company's EBITDA base yet. However, we continue to view the company's creditworthiness as weaker than that of its 'BBB' rated peers such as Heimstaden, or Cofinimmo for example, both comparable in terms of business risk profile assessments but stronger in the financial risk profile departments, in our view, supported by stronger and more stable debt and debt-plus-equity ratios (50.5% and 44.3%, respectively, as of first-quarter 2022 and fourth-quarter 2021).

We believe that SBB's cash on hand and unused committed credit lines will be enough to absorb upcoming debt maturities in the next 12 months. The company faces maturing debt of SEK15.5 billion in the next 12 months. We believe the upcoming maturities remain covered by its cash on balance of SEK 8.9 billion and undrawn committed facilities of roughly SEK6.2 billion, mainly maturing in more than 24 months. In addition, the company recently signed a revolving credit facility (RCF) of €350 million, bringing its ratio of liquidity sources above 1.2x. We understand close to half of SBB's short-term debt maturities are commercial paper, which is likely to be rolled over. Yet we recognize that the company has significant debt maturities of SEK14.7 billion in 2023 and SEK24 billion in 2024. We will continue to monitor closely how the company addresses these.

Outlook

The stable outlook indicates that SBB's portfolio should benefit from high demand in its resilient asset segments, supporting cash flow. We expect like-for-like rental income will increase by 1.5%-2.0% in the next 12-24 months. Over the next six months, we expect the company to deleverage and exhibit financial discipline, with the debt-to-debt-plus-equity ratio remaining near 52%-54% (including our adjustments for the hybrid capital) sustainably. We also project its EBITDA interest coverage will remain near 2.8x-3.0x

Downside scenario

We could lower the rating 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 continue its growth strategy with debt financing acquisitions or if operating performance is materially weaker than forecast. 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 the debt capital markets, in particular in the company's bond trading, such that it would face refinancing risks.

Upside scenario

We could raise the rating if SBB's credit metrics improve, such that:

- Debt to debt plus equity stayed firmly well below 55%;
- EBITDA interest coverage strengthened to 3x or higher sustainably;
- Debt to EBITDA declined toward 15x or below, with the company maintaining a sizable portfolio of resilient asset classes in favorable locations; and
- The company restored debt's investors' confidence and disposed of assets as planned.

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%).

Our Base-Case Scenario

In our base-case scenario, we assume:

- Real GDP growth in Sweden of 2.3% and 2.1% for 2022 and 2023 and consumer price index growth of 4.9% and 2.3%, respectively.
- Annual like-for-like rental income growth of 1.5%-2.0% for SBB's properties in the next two

years.

- Stable occupancy rate of 97%-98%, reflected in strong anticipated demand.
- An improvement in the EBITDA margin to 65%-68% for the next 12-24 months, primarily reflecting a higher contribution of dividend from its joint venture (JV) and associates, as well as some synergies from recent acquisitions.
- Like-for-like overall portfolio revaluation of 1.5%-2.0% for 2022-2023, supported by sound demand and limited supply features in SBB's markets.
- Annual capital expenditure (capex) of SEK3.5 billion-SEK4.0 billion in the next 12-24 months, including development projects (a mix of JVs, turnkey business, and direct development).
- The continued disposal of assets over the next 12 months, resulting in broadly balanced acquisitions and disposals for 2022 (already SEK2.8 billion of acquisitions completed year to date).
- Average costs of 1.5%-2.0% excluding the hybrid instrument over the next 12-24 months.

Based on these assumptions, we arrive at the following credit measures over the next 12-18 months:

- EBITDA to interest coverage remaining at 2.8x-3.0x in 2022 and 2023.
- Adjusted debt to debt plus equity remaining at 52%-54% in 2022, with some further improvement in 2023.
- Debt to EBITDA of 17x-19x, including the full-year effect of recent acquisitions.

Liquidity

We assess SBB's liquidity as adequate, based on our estimate that the company's liquidity sources will likely cover uses by more than 1.2x in the 12 months starting April 1, 2022. SBB's cash balances of SEK8.9 billion and revolving credit facility (RCF) will cover for short term maturities of 12 months ahead.

Principal liquidity sources include:

- SEK8.9 billion in available unrestricted cash.
- The SEK 6.2 billion RCF with a maturity of more than 24 months.
- The RCF of €350 million signed after the first quarter.
- Our estimate of funds from operations of SEK3.5 billion-SEK4.0 billion.
- Signed asset disposal of SEK2.8 billion signed after first-quarter.

Principal liquidity uses include:

- SEK15.5 billion of contractual debt amortization payments, of which we understand SEK5.2 billion refers to commercial paper.
- Dividends of about SEK2.7 billion.
- Committed capex spending of around SEK1.5 billion.

Covenants

We understand that SBB needs to comply with covenants for its existing bond issuances and credit lines. We estimate that the headroom under these covenants is adequate, at more than 10%.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-3

Governance factors have a moderately negative influence on our credit rating analysis of SBB, since 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.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of first-quarter 2022, SBB's capital structure comprised interest-bearing liability amounting to SEK95.0 billion in the form of loans to credit institutions of SEK35.8 billion, senior unsecured bonds of SEK52.9 billion, commercial paper of SEK6.3 billion, and hybrid bonds SEK17.3 billion. At March 31, 2022, the proportion of interest-bearing liabilities with fixed interest was 66%, with an average debt maturity of 3.9 years.

Analytical conclusions

We rate SBB's senior unsecured bonds 'BBB-', in line with the issuer credit rating given the limited portion of secured debt (secured debt to total assets was 18% as of first-quarter 2022). We think the ratio will remain below our threshold of 40%. We rate the subordinated hybrid notes 'BB', two notches below the issuer credit rating, as per our approach for hybrid capital.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
Business risk:	Strong
Country risk	Very low
Industry risk	Low
Competitive position	Strong
Financial risk:	Significant

Issuer Credit Rating	BBB-/Stable/A-3
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)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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: 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 SBB 'BBB-' Rating Affirmed Following Independent Audit; Outlook Remains Positive, April 14, 2022
- Samhällsbyggnadsbolaget i Norden's 2021 Results Show Sustained Credit Metrics Amid High Asset Rotation, Feb. 25, 2022
- Samhallsbyggnadsbolaget i Norden AB Outlook Revised To Positive; 'BBB-' Ratings Affirmed, March 1, 2021
- Swedish Property Company SBB Affirmed At 'BBB-' On Proposed Acquisition Of Norwegian Peer

Entra; Outlook Stable, Nov. 30, 2020

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Samhallsbyggnadsbolaget i Norden AB (publ)		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Positive/A-3
Senior Unsecured	BBB-	
Subordinated	BB	
Commercial Paper	A-3	
SBB Treasury OYJ		
Senior Unsecured	BBB-	