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Research Update:

Swedish Public Housing Company Forvaltaren Outlook To Stable On Improved Financial Position; 'AA-/A-1+' Ratings Affirmed

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Research Update:

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Overview

- On the back of asset sales, we anticipate that the Swedish public housing provider Förvaltaren will amortize debt, which will reduce the company's debt burden and improve its liquidity position.
- We are therefore revising our outlook on Förvaltaren to stable from negative, and affirming our 'AA-/A-1+' and 'K-1' ratings on the company.
- The stable outlook reflects our expectation that Förvaltaren will maintain its financial position through 2020, supported by robust earnings, strong market fundamentals, and prudent management.

Rating Action

On Oct. 25, 2018, S&P Global Ratings revised its outlook on Swedish public housing provider Fastighets AB Förvaltaren to stable from negative.

At the same time, we affirmed our 'AA-/A-1+' long- and short-term issuer credit ratings and our 'K-1' Nordic regional scale rating on the company.

Rationale

We have revised our outlook on Förvaltaren back to stable due to its improved financial position after the divestment of a number of properties. Förvaltaren has used the proceeds to amortize enough debt that we do not see an imminent risk of a structural deterioration of the company's debt burden. Furthermore, stemming from the asset sales, the company's liquidity position has improved. We also expect Förvaltaren to uphold its stable and predictable earnings on the back of strong demand for rental housing and Förvaltaren's generally well-maintained properties. In addition, we expect Förvaltaren will maintain its liquidity position, supported by a prudent and risk-averse management team that will contract sufficient backups to keep refinancing risks at a minimum.

We base our ratings on Förvaltaren on the company's stand-alone creditworthiness and our opinion of a high likelihood of extraordinary support from its owner, the city of Sundbyberg. The assessment of the likelihood of support is based on Förvaltaren's:

- Important role for Sundbyberg. Förvaltaren is regarded as a key

contributor to Sundbyberg's overall infrastructure and public policy. The company plays an important role in accommodating the increasing population and acts as a means of improving integration in the city; and

- Very strong link with Sundbyberg, which is actively involved in defining Förvaltaren's strategy, appoints the company's board of directors, and intends to maintain its 100% ownership over the medium term.

Förvaltaren operates in an industry we view as low-risk, characterized by regulatory surveillance along with stable earnings with no major sensitivity to economic cycles. The company has a very strong position in Sundbyberg's housing market, where roughly one-third of the city's inhabitants live in properties owned by the company. Sundbyberg is closely integrated with the capital city of Stockholm with regard to, for example, its labor market and public infrastructure. Sundbyberg is one of the fastest-growing municipalities in Sweden, with an average population growth of almost 4% annually for the past three years. Vacancies are low and under 2% of rent receivables by our calculation. We view vacancy risk as limited owing to the strong market fundamentals in the region, with high demand and a shortage of rental housing properties. Although property prices in the Stockholm region have stabilized somewhat over the past two years, property prices in Sundbyberg are very high, and we calculate the dwelling price in Sundbyberg at a high 191% of the national average.

Förvaltaren's properties are, in our view, generally well-maintained, and the company has worked proactively in maintenance projects. These efforts have enhanced the properties' technical age, which by the end of 2017 was about 38 years. Although Förvaltaren has had fairly high maintenance expenses in recent years, the trend has been decreasing and we expect to see a stabilization of the maintenance expenses over the coming years.

Overall, we consider Förvaltaren's management to be strong, supported by an experienced team that proactively manages the company's financial and operational risks. However, we have observed that the city of Sundbyberg's governance and financial strategies regarding its subsidiaries is somewhat weaker than that of peers.

Together with a number of other developers, Förvaltaren is involved in the construction of multifamily housing in the city. We expect Förvaltaren's capital expenditures (capex) in new construction and refurbishment will average Swedish krona (SEK) 355 million (€34 million) through 2020, which is in line with investment levels for the past two years. Förvaltaren has sold and transformed a couple of rental properties into condominiums in order to deleverage the balance sheet, and promote integration in some of the city districts by mixing the housing forms. It has used the proceeds to amortize debt, and we expect its debt level to decrease in 2018. Due to cash inflows from already-sold properties, we forecast that Förvaltaren will have limited borrowing needs in 2019, which will increase in 2020. Consequently, we estimate that Förvaltaren's net new borrowings will average approximately SEK130 million per year in 2019 and 2020. As a result, we expect that

Förvaltaren's debt will decrease slightly to 13.4x of EBITDA in 2020, compared with 14.4x in 2017 (its five-year average debt-to-EBITDA ratio is down to 14.1x from 18.7x in our last review). In our forecast, we have conservatively assumed limited inflows related to new divestments. However, we acknowledge the possibility of further divestments, which would decrease borrowing needs even more.

By year-end 2017, the market value of Förvaltaren's properties amounted to SEK13.7 billion. In our view, the balance sheet remains strong, supported by a robust loan-to-value ratio of 21%. We estimate the ratio will improve further in 2018 as debt amortizes. This provides comfortable headroom for the company to absorb additional funding. We expect Förvaltaren's EBITDA interest coverage ratio will remain strong at 4.2x, compared to 3.1x in last review. Although we observe that Förvaltaren's debt portfolio has a short-term profile, with about 45%-50% of it maturing within 12 months, we do not consider it a negative factor for the ratings.

In our base case, we estimate that Förvaltaren's EBITDA will remain stable around 24% of revenues throughout 2020, supported by strong demand, shortage of housing and strong population growth in Sundbyberg and the larger Stockholm region. In our view, the currently low interest rate environment will provide further support to Förvaltaren's financial performance. We incorporate into our calculations of the company's EBITDA about SEK95 million of capitalized maintenance costs, which we consider operating expenditures.

Liquidity

Due to the lower level of upcoming maturing debt, Förvaltaren's liquidity position has improved and we estimate that the liquidity sources now cover 1.24x of liquidity uses, compared to 0.92x in previous review. Due to the divestments, Förvaltaren currently holds a large cash position. We anticipate that the company will use these funds to amortize debt in 2018 and 2019, and that the cash holdings will gradually decrease. Similar to other municipal-owned public housing providers, we consider Förvaltaren to have a strong access to external liquidity, as rated entities have a track record of tapping the financial markets even in periods of financial stress.

Liquidity sources include:

- Estimated long-term cash level of SEK200;
- SEK188 million of cash inflows from sold assets;
- Estimated operating cash flow of SEK174 million; and
- Committed and undrawn liquidity facilities of SEK1.4 billion.

Liquidity uses include:

- Expected capex of SEK342 million;
- Maturing debt and interest of SEK1.2 billion; and
- SEK22 million of dividends.

Outlook

The stable outlook reflects our view that, over the coming two years, Förvaltaren will maintain its stable and robust earnings on the back of strong economic fundamentals in the region. In addition, we anticipate Förvaltaren will manage debt and liquidity prudently to mitigate refinancing risks. Furthermore, we do not expect any material change in Förvaltaren's ownership or support structure that would make us revise our assessment of the company's role for or link to Sundbyberg.

The ratings could come under pressure if we observed a deterioration in Förvaltaren's financial position. This could happen if management lost control of operating spending, which would cause EBITDA to drop, and a more relaxed attitude to financial policies caused its liquidity to deteriorate. We could also lower the ratings if Förvaltaren's role for or link to Sundbyberg weakened.

We could consider raising the ratings on Förvaltaren if we observed a marked improvement of the company's financial position. This would include an improved financial performance, likely as a result of improved cost control elevating the EBITDA margins above 30%. The stronger financial performance would enable Förvaltaren to amortize debt to a level below 10x EBITDA. We could also consider an upgrade if Förvaltaren's role for or link to Sundbyberg strengthened.

Table 1

Fastighets AB Förvaltaren Financial Statistics					
	--Year ended Dec. 31--				
(Mil. SEK)	2016	2017	2018bc	2019bc	2020bc
Number of units	7,826.0	6,939.0	N.A.	N.A.	N.A.
Vacancy rates (% of net rental income)	2.1	1.2	N.A.	N.A.	N.A.
Arrears (% of net rental income)*	N.A.	N.A.	N.A.	N.A.	N.A.
Revenue	805.0	787.0	707.0	723.0	736.0
Share of revenue from nontraditional activities (%)	0.0	0.0	0.0	0.0	0.0
Operating expense	497.0	490.0	446.0	453.0	461.0
EBITDA§	172.0	202.0	166.0	175.0	179.0
EBITDA/revenue (%)	21.4	25.7	23.5	24.2	24.4
Interest expense	61.0	58.0	39.0	33.0	35.0
Debt/EBITDA (x)	17.1	14.4	12.9	12.5	13.4
EBITDA/interest coverage (x)†	2.8	3.5	4.3	5.3	5.2
Capital expense	417.0	304.0	249.0	361.0	455.0
Debt	2,940.0	2,900.0	2,150.0	2,181.0	2,412.0
Housing properties (according to balance-sheet valuation)	5,478.0	5,263.0	4,521.0	4,557.0	4,822.0
Loan to value of properties (%)	20.8	21.2	N.A.	N.A.	N.A.

Table 1

Fastighets AB Förvaltaren Financial Statistics (cont.)					
	--Year ended Dec. 31--				
(Mil. SEK)	2016	2017	2018bc	2019bc	2020bc
Cash and liquid assets	224.0	198.0	200.0	200.0	200.0

*Rent and service charge arrears. §Adjusted for grant amortization. †Adjusted for capitalized repairs. **Including capitalized interest. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Table 2

Fastighets AB Förvaltaren Ratings Score Snapshot	
Industry risk	2
Economic fundamentals and market dependencies	1
Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	4
Debt profile	2
Liquidity	3
Financial policies	2
Financial profile	3

S&P Global Ratings' analysis of social housing providers' creditworthiness rests on our scoring of eight key rating factors: (i) industry risk; (ii) economic fundamentals and market dependencies; (iii) strategy and management; (iv) asset quality; (v) financial performance; (vi) debt profile; (vii) liquidity; and (viii) financial policies. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, detail how we derive and combine the scores, and then determine each social housing provider's stand-alone credit profile and the issuer credit rating. In accordance with S&P Global Ratings' public and nonprofit social housing providers methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating, the committee can make use of the flexibility afforded by paragraphs 12-17 of "Methodology For Rating Public And Nonprofit Social Housing Providers."

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Global Ratings Definitions, April 19, 2018

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Fastighets AB Forvaltaren Issuer Credit Rating	AA-/Stable/A-1+	AA-/Negative/A-1+

Ratings Affirmed

Fastighets AB Forvaltaren Issuer Credit Rating	
Nordic Regional Scale	--/--/K-1
Commercial Paper	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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