

Research Update:

# Specialfastigheter 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

December 20, 2023

## Overview

- Rising crime rates in Sweden have increased demand for Specialfastigheter Sverige AB's services given its position as a near-monopoly provider of prison properties and other critical premises from a security perspective.
- This implies strong ongoing support from the Swedish government and a very high likelihood of extraordinary support for the company if needed.
- However, the heightened demand for prison properties also raises investments, leading to higher debt.
- We affirmed our 'AA+/A-1+' and 'K-1' ratings on Specialfastigheter and maintained a stable rating outlook.

## Rating Action

On Dec. 20, 2023, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit rating on Swedish property company Specialfastigheter Sverige AB. The outlook on the long-term rating is stable.

At the same time, we affirmed our 'K-1' Nordic regional scale rating on the company.

## Outlook

The stable outlook reflects our expectation that Specialfastigheter will, in dialogue with its owner, the Swedish government, contain the buildup of debt. Furthermore, we assume the government will remain the sole owner of Specialfastigheter and that the company will continue to play a very important role in supporting the government's policy in law enforcement.

## Downside scenario

The ratings could come under pressure if Specialfastigheter's management does not proactively

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adjust its capital expenditure (capex) to avoid greater debt accumulation than planned, leading to debt to EBITDA higher than 20x and EBITDA to interest coverage dropping below 1.75x. We could also take a negative rating action if we view Specialfastigheter's role for, or link with, its owner as weakening.

### Upside scenario

We could consider a positive rating action if the company's link to, or role for, the government were to improve. Ratings upside could also follow a strengthening of its stand-alone credit profile (SACP), for example thanks to markedly and sustainably reduced debt together with a structural improvement of its liquidity position.

### Rationale

Given a recent trend of higher crime rates in Sweden, we expect Specialfastigheter will increase investments considerably, which will pressure its debt metrics. That said, we believe Specialfastigheter will have a dialogue with its owner, containing capex and buildup of debt, thereby keeping its solvency rate (equity to total assets) within its target range of 25%-40%, with debt to EBITDA below 20x, and EBITDA interest coverage above 1.75x.

We assess Specialfastigheter's enterprise risk and financial risk profiles and the components of its SACP by benchmarking against factors we consider in our "Methodology For Rating Public And Nonprofit Social Housing Providers," published June 1, 2021. The ratings reflect the combination of our assessment of Specialfastigheter's 'aa-' SACP and our view of a very high likelihood that Specialfastigheter's owner, the government of Sweden (unsolicited; AAA/Stable/A-1+), would provide timely and sufficient extraordinary support to the company in the event of financial distress.

### Enterprise profile: Low industry risk, strong demand for Specialfastigheter's properties, and close interaction with Sweden's government

In our view, Specialfastigheter operates in a low-risk industry with limited exposure to cyclicalities. Specialfastigheter owns and manages most of Sweden's prisons, juvenile detention centers, court buildings, and headquarters for the defense and police authorities. All tenants are state agencies, most of which provide services deemed essential to Sweden's public safety and national security. The company offers highly specialized and tailor-made premises and benefits from long lease contracts, which enable long-term relationships with tenants and stable revenue streams. This supports our view on Specialfastigheter's market position.

Boosted by the government's high priority in combatting increased crime rates, Specialfastigheter's business risk remains low. In September 2023, the average remaining term of Specialfastigheter's lease contract portfolio was over 10 years. The terms and conditions do not permit early termination of a contract without full compensation from the tenant for the remainder of the lease, which in our view reduces operational risk. Moreover, most rental contracts contain clauses linked to the consumer price index, which offsets a large part of the risk associated with capex increases. Furthermore, long lease contracts with government agencies ensure minimal vacancies, currently less than 1%. We also think Specialfastigheter benefits from having very few competitors in this niche market, supporting robust demand for its high-security properties.

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We do not expect a recent change in management will lead to material strategy changes, given the long-term nature and importance of Specialfastigheter's mission to provide high-security properties. Specialfastigheter has recently appointed a new CEO and CFO, both with experience in real estate and carrying out ambitious construction projects. Overall, we see management's key strengths in its prudent long-term planning, sophisticated budget and review process, and well-established risk management practices, including those related to refinancing and interest rates. Management also has a history of achieving financial targets, including the return on operating capital and solvency ratio.

We assess the regulatory framework for Swedish real estate companies with a clear public policy focus as strong (see "Regulatory Framework Assessment: Swedish Public Real Estate Companies Are Supervised Through Their Integration With Owners," published May 25, 2023, on RatingsDirect).

### Financial profile: A significant rise in capex may pressure credit metrics and the solvency ratio will likely decrease but remain within targets

Specialfastigheter benefits from stable and predictable cash flows from its operations. After a temporary dip in 2022, we estimate operating cash flows will remain strong in 2023-2025. This is because rental increases are typically indexed at 85% of inflation and completed capital projects will start to generate revenue. Overall, we assume strong five-year average adjusted EBITDA margins at 58%, broadly unchanged from our previous forecast.

Since our last review in 2022, the Swedish government has adopted a program aimed at significantly increasing capacity at prisons. For Specialfastigheter, this implies additional investments on top of an already ambitious capex plan. Consequently, we now forecast Specialfastigheter will invest sizable amounts throughout 2023-2025. We expect the company will not have to pay dividends and be able to self-finance part of these investments. However, most will likely be funded by debt, resulting in debt almost doubling in 2022-2025.

With this assumption, we estimate a weakening of the company's non-sales debt-to-EBITDA ratio and EBITDA interest coverage ratio. Furthermore, beyond 2025, we foresee further weakening of debt metrics before they start to improve. Consequently, we now assess Specialfastigheter's debt profile as strong rather than very strong.

### Liquidity

We consider that Specialfastigheter has an overall adequate liquidity position, with liquidity sources covering uses by 1.16x over the next year. As such, we assume sources will cover uses by 1.00x-1.25x on a structural basis, in line with previous years. In our base case over the next 12 months, we estimate sources of cash at about SEK12.9 billion will cover uses of about SEK10.9 billion.

The company's liquidity sources comprise covered bond holdings of roughly SEK3.2 billion, cash flow from operations of about SEK2.0 billion, and undrawn contractually committed facilities of SEK7.8 billion expiring beyond 12 months. Principal liquidity uses include capex on repairs and new development of SEK6.0 billion, and debt service (including interest costs) of about SEK5.0 billion. We assume there will be no dividend payments.

We also consider Specialfastigheter's strong market access in assessing its overall liquidity position. This is because we view the company as a stable and trusted issuer that has successfully tapped the market for financing, even during periods of market stress. We also recognize the

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likelihood that the central government is likely to waive dividend payments should there be any disruption to Specialfastigheter's access to funding.

### Government-related entity analysis: A very high likelihood of support

We see a very high likelihood that Specialfastigheter would receive timely and sufficient support from the Swedish government if it experienced any financial distress. We therefore apply a two-notch uplift to our SACP assessment to derive our rating on Specialfastigheter.

We base our view on Specialfastigheter's very important role, owing to its unique position as a provider of essential, state-funded properties built to maintain public safety and national security. Specialfastigheter operates as an independent entity and plays a very important role in meeting political objectives and implementing a key national policy.

We also consider the company's very strong link to the Swedish government, which fully owns Specialfastigheter. The government is actively involved in defining the company's strategy, appoints its board, and has a long-term commitment to the company. In addition, the Swedish government has a track record of supporting government-related entities, and any unremedied financial distress at the company would pose significant reputation risk for the government.

### Selected Indicators

Table 1

#### Specialfastigheter--Financial statistics

Mil. SEK	--Year ended Dec. 31--				
	2021	2022	2023bc	2024bc	2025bc
Adjusted operating revenue	2,464.00	2,456.00	3,010.00	3,352.30	3,714.60
Adjusted EBITDA	1,443.00	1,359.00	1,725.60	1,953.50	2,206.00
Non-sales adjusted EBITDA	1,443.00	1,359.00	1,725.60	1,953.50	2,206.00
Capital expense	1,399.00	3,857.00	5,978.40	6,157.70	6,465.60
Debt	15,775.00	20,308.00	25,208.00	32,308.00	37,708.00
Interest expense	117	242	611.2	868.2	1,057.70
Adjusted EBITDA/Adjusted operating revenue (%)	58.6	55.3	57.3	58.3	59.4
Debt/Non-sales adjusted EBITDA (x)	10.9	14.9	14.6	16.5	17.1
Non-sales adjusted EBITDA/interest coverage(x)	12.3	5.6	2.8	2.3	2.1

bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

### Ratings Score Snapshot

Table 2

#### Specialfastigheter--Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2

Table 2

**Specialfastigheter--Ratings Score Snapshot (cont.)**

Assessment	
Regulatory framework	3
Market dependencies	2
Management and governance	2
Financial risk profile	2
Financial performance	1
Debt profile	3
Liquidity	3
Stand-alone credit profile	aa-
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on nonprofit social housing providers on the seven main rating factors listed in the table above. Our "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

**Related Criteria**

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

**Ratings List**

**Ratings Affirmed**

**Specialfastigheter Sverige AB**

Issuer Credit Rating	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1

**Specialfastigheter Sverige AB**

Commercial Paper	K-1
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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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings

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