S&P Global Ratings

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Specialfastigheter Sverige AB

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This report does not constitute a rating action.

Credit Highlights

Overview

Enterprise profile	Financial profile
Specialfastigheter benefits from low industry risk in the public property sector, thanks to limited exposure to business cycle fluctuations, a stable tenant base of state-owned agencies, and a very strong relationship with its owner, Sweden's central government.	Despite pressures stemming from rising inflation and the increasing cost base, Specialfastigheter's inflation-linked revenues will help maintain the S&P Global Ratings-adjusted EBITDA margin at a strong level.
--We believe long-lease contracts, well-established cooperation with tenants, and a conservative approach to project management are key factors in keeping vacancy rates stable at less than 2%.	--While capital expenditure (capex) is currently increasing significantly compared with historical levels, we think Specialfastigheter will lower dividends from 2023, which somewhat balances the funding need.
--With a strong market share of properties for prisons and other properties linked to Sweden's domestic security and general safety, Specialfastigheter faces limited competition.	--We expect prudent financial management will contain risks related to debt build up, such as increasing interest rates.
--We consider that Specialfastigheter's management team has strong expertise and long experience in the company's major operating segments.	--We expect liquidity to remain solid, with ample back-up facilities, cash, and highly liquid securities.

Outlook

The stable outlook reflects our expectation that a reduction in dividend payments from Specialfastigheter to its owner, Sweden's central government, would largely offset the risks associated with increasing capex needs in the next few years.

Downside scenario

The ratings could come under pressure if Specialfastigheter embarks on a more aggressive capital investment plan than we currently anticipate, without offsetting financial measures, such as reducing dividend payments. In this scenario, liquidity could weaken, and debt could build to a level above 15x EBITDA, which would also negatively affect our view of the company's financial management. 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, in our view, the company's link to, or role for, the government were to improve, for example if formal guarantee commitments were extended to the company. Ratings upside could also follow the strengthening of its stand-alone credit profile (SACP), for example thanks to sustainably reduced debt, including a marked reduction of short-term debt that structurally strengthens the liquidity position and the company's balance sheet resilience.

Rationale

Specialfastigheter owns and manages most of Sweden's prisons, as well as several juvenile detention centers, defense, and police authority properties. In our view, Specialfastigheter operates in a low-risk industry with limited exposure to cyclicality. This was further illustrated during the pandemic-triggered economic downturn, which had a minimal impact on the company's operations and performance. 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.

According to our criteria "Principles Of Credit Ratings," published Feb. 16, 2011, we assess Specialfastigheter's enterprise risk and financial risk profiles, the components of its SACP, by benchmarking against factors we consider in our methodology for rating public and non-profit social housing providers published June 1, 2021.

We assess the regulatory framework for Swedish real estate companies with a clear public policy focus as strong (see "Regulatory Framework Assessment: Government-Owned, Public Policy-Focused Real Estate Companies In Sweden," published Sept. 23, 2021).

The ratings reflect the combination of our assessment of Specialfastigheter's 'aa-' SACP and our view of a very high likelihood that the company's owner, Sweden (unsolicited; AAA/Stable/A-1+), would provide timely and sufficient extraordinary support to the company in the event of financial distress. In accordance with our criteria for government-related entities (GREs), our view of a very high likelihood of extraordinary government support is based on our assessment of Specialfastigheter's:

-Very important role in Sweden's economy, from a 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; and

-Very strong link with the Swedish government, which fully owns Specialfastigheter, 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 the GRE sector, and any unremedied financial distress at the company would pose significant reputation risk for the government.

In September 2022, 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 lowers the operational risk. Moreover, the majority of 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 2%, and further support the company's very strong enterprise risk profile. We also think Specialfastigheter benefits from having very few competitors in this niche market, supporting robust demand for high-security properties.

Specialfastigheter recently announced that its CEO is leaving in June 2023. However, we do not expect this 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. Furthermore, the current management team has extensive experience in the construction and real estate sectors. We see the key strengths of the management are its prudent long-term planning, sophisticated budget and review process, and well-established risk management practices. This is also evidenced by its history of reaching set financial targets, including return on operating capital and solvency rate. Importantly, its strategic direction is very stable and consistent because expansion plans depend largely on the government's decisions and policies, in addition to tenant demand.

Specialfastigheter enjoys a very strong financial risk profile, underpinned by stable and predictable cash flows from its operations and a resilient balance sheet. We estimate operating cash flows will remain strong in 2022-2024 despite a slight decline in adjusted EBITDA margins for 2022-2023, as the rental increases do not fully cover the inflationary cost pressure, because rental increases are typically indexed at 85% of inflation. Even though we expect a slight decline in adjusted EBITDA margins over the next two years, we assume Specialfastigheter will benefit from increasing revenue growth in a few years' time when its current major capital projects are completed. We expect the S&P Global Ratings-adjusted EBITDA margins to start increasing again in 2024. Overall, we assume strong five-year average adjusted EBITDA margins at 58%, from 59% in our previous forecast. Given this relatively high adjusted EBITDA margin, in our view, Specialfastigheter has a sufficient financial buffer to handle increasing cost pressure.

We expect capex to increase significantly in the coming years to meet the demand for additional high-security properties. As such, we expect the company will invest an average of about Swedish krona (SEK) 3.5 billion annually until 2024. To finance this capex, we expect there will be additional debt buildup. We forecast the nonsales debt-to-EBITDA ratio at 14x in 2024, up from 11x in 2021. However, given the upcoming significant increase in investments, we think Specialfastigheter will lower dividends from 2023, which we consider balances the funding need somewhat.

We also expect a significant drop in EBITDA interest coverage, from 12x in 2021 to 4x in 2024, to reflect the increasing interest rate environment. Despite the increasing interest rate environment and higher debt, we consider Specialfastigheter to have an experienced and proactive debt management, with a conservative maturity profile and well-managed handling of currency and interest rate risk. Specialfastigheter currently has about 30% of its total debt at a variable rate. Similar to other Swedish entities, the interest cost is associated with significantly shorter debt duration compared with the economic lifetime of its properties.

Liquidity

We consider that Specialfastigheter has an overall adequate liquidity position, with liquidity sources covering uses by 1.4x over the next year. However, we do not expect Specialfastigheter to keep this level of liquidity on a structural level, reflecting the increased level of capex over the next few years. As such, we assume liquidity levels will rather be at about 1.00x-1.25x on a structural level, in line with historical years. Its liquidity sources comprise internal cash flow and committed liquidity facilities, which balance the maturing debt and expected cash outflows for capital spending and dividends. In our base case over the next 12 months, we estimate sources of cash at about SEK10.5 billion will cover uses of about SEK7.8 billion.

Principal liquidity sources include:

-Covered bond holdings of roughly SEK2.2 billion;

-Cash flow from operations of about SEK1.6 billion; and

-Undrawn contractually committed facilities of SEK6.8 billion expiring beyond 12 months.

Principal liquidity uses include:

-Capex on repairs and new development of SEK4.1 billion;

-Dividends of SEK0.3 billion; and

-Debt service (including interest costs) of about SEK3.3 billion.

We also take into account Specialfastigheter's strong market access in assessing its overall liquidity position, 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 likelihood that the central government owner is likely to waive dividend payments should there be any disruption to Specialfastigheter's access to funding.

Environmental, Social, And Governance

We think Specialfastigheter ESG performance is broadly in line with sector peers. We consider social risks to be limited for Specialfastigheter, given its core business of providing high-security properties with purely state-owned tenants. Consequently, during the pandemic outbreak, rental revenues were hardly affected given the long-term nature of rental contracts.

In terms of environmental factors, Specialfastigheter has set up internal targets of reducing green-house gas emissions in line with the Paris agreement, and to reach its zero-emission target by 2045. Specialfastigheter aims to improve cost and energy efficiency and improve transparency. We consider this approach to be largely in line with peers.

We also have a neutral view on Specialfastigheter's governance and financial policies and consider them in line with most of its peers.

Key Statistics

Specialfastigheter Sverige AB--Key Statistics

	Year ended Dec. 31				
Mil. SEK	**2020**	**2021**	**2022bc**	**2023bc**	**2024bc**
Number of units owned or managed	--	--	--	--	--
Adjusted operating revenue	2,393.0	2,464.0	2,488.6	2,762.4	3,038.6
Adjusted EBITDA	1,438.0	1,443.0	1,417.8	1,551.1	1,761.2
Nonsales adjusted EBITDA	1,438.0	1,443.0	1,417.8	1,551.1	1,761.2
Capital expense	801	1,399	2,894.8	4,146.5	3,515.8
Debt	14,282	15,775	17,985	21,373	24,025
Interest expense	126	117	206.3	330.2	465.2
Adjusted EBITDA/Adjusted operating revenue (%)	60.1	58.6	57.0	56.2	58.0
Debt/Nonsales adjusted EBITDA (x)	9.9	10.9	12.7	13.8	13.6
Nonsales adjusted EBITDA/Interest coverage (x)	11.4	12.3	6.9	4.7	3.8

Bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available. SEK--Swedish krona.

Rating Component Scores

Specialfastigheter Sverige AB--Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	3
Market dependencies	2
Management and Governance	2
Financial risk profile	2
Financial performance	1
Debt profile	2
Liquidity	3

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Regulatory Framework Assessment: Government-Owned, Public Policy-Focused Real Estate Companies In Sweden, Sept. 23, 2021

Ratings Detail (as of December 19, 2022)*

Specialfastigheter Sverige AB		
Issuer Credit Rating		AA+/Stable/A-1+
Nordic Regional Scale		--/--/K-1
Commercial Paper		
Nordic Regional Scale		K-1
Senior Unsecured		AA+
Issuer Credit Ratings History		
08-Nov-2005		AA+/Stable/A-1+
12-Apr-1999		AA/Stable/A-1+
12-Apr-1999	*Nordic Regional Scale*	--/--/K-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.