

Research Update:

Swedish Public Property Company Specialfastigheter Sverige Affirmed At 'AA+/A-1+'; Outlook Stable

December 18, 2020

Overview

- Specialfastigheter benefits from low risk in the public-sector property industry, thanks to limited exposure to business cycle fluctuations, further illustrated during the COVID-19 pandemic; a stable tenant base of state-owned agencies; and a very strong relationship with its owner, Sweden's central government.
- In our base case for 2020-2022, we expect that Specialfastigheter's sustained strong profitability will counterbalance its maintenance and construction program, supporting interest coverage at around 10x, and contain debt accumulation.
- We are therefore affirming our 'AA+/A-1+' and 'K-1' ratings on Specialfastigheter.
- The stable outlook reflects our expectation that Specialfastigheter's very strong enterprise risk profile will support strong financial performance, ensuring robust debt sustainability and adequate liquidity.

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Rating Action

On Dec. 18, 2020, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on Swedish public property provider Specialfastigheter Sverige AB. The outlook is stable.

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

Rationale

The ratings reflect the combination of our assessment of Specialfastigheter's 'aa-' stand-alone credit profile (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 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.

According to our criteria "Principles Of Credit Ratings," published Feb. 16, 2011, on RatingsDirect, we assess Specialfastigheter's enterprise risk and financial risk profiles, the components of its SACP, by benchmarking against factors described in our criteria for rating public housing providers.

Specialfastigheter operates in a low risk industry with limited exposure to cyclical. This has been further illustrated during the pandemic-triggered economic downturn, which has had a minimal impact on the company's operations and performance. We believe that Specialfastigheter's tenant base, consisting almost exclusively of central government agencies, is a key support to its very strong enterprise risk profile. Specialfastigheter owns and manages the majority of Sweden's prisons, and several defense and police authority properties. All its 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.

In October 2020, the average remaining term of Specialfastigheter's lease contract portfolio was close to 11 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. Moreover, the majority of contracts contain index clauses offsetting a large part of the risk associated with expenditure 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 consider Specialfastigheter's strategic planning to be sophisticated. The company sets long-term goals for financial and operational performance, and it has well-established processes and procedures for budgeting and follow up. Moreover, 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. Over the past few years, we have observed further streamlining of Specialfastigheter's property portfolio with the sale of properties for specialized education. As such, the company is increasingly focusing on its core holdings within security-intense properties. We consider that Specialfastigheter's management team has strong expertise and long experience in the company's major operating segments.

Specialfastigheter enjoys a very strong financial risk profile, underpinned by stable and predictable cash flows from its operations and resilient balance sheet. We estimate operating cash flows will remain strong in 2020-2022 with an EBITDA margin of about 62% on average. We expect the company to invest an average of about Swedish krona (SEK) 1.1 billion (about \$132 million) annually and pay out annual dividends of about SEK590 million over the coming three years. Nevertheless, we anticipate that robust cash flows from operations will materially limit the

need for debt financing, containing the increase in debt to EBITDA to 12x by year-end 2022, versus 10.3x in 2019. We expect EBITDA interest coverage will remain strong, benefitting from still low interest rates. Hence, we estimate the company's EBITDA interest coverage will average about 11x over 2020-2022. However, we note that Specialfastigheter's financial policy allows for up to 70% of the debt portfolio being exposed to interest risk, and that typically 40%-50% of the portfolio is exposed to such risk, which we view as negative for the overall risk associated with its debt burden.

Liquidity

We consider that Specialfastigheter has an adequate liquidity position overall. Its liquidity sources comprise internal cash flow and committed liquidity facilities, which balance 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 SEK7.3 billion will cover uses of about SEK6.4 billion by 1.1x.

Sources include:

- Cash of around SEK0.8 billion due to covered bond holdings of about SEK1.1 billion, to which we apply a 30% haircut;
- Cash flow from operations of around SEK1.4 billion; and
- Undrawn contractually committed facilities of SEK5.05 billion expiring beyond 12 months.

Uses include:

- Capital expenditures on repairs and new development of SEK1.6 billion;
- Dividends of SEK0.6 billion; and
- Debt service (including interest costs) of about SEK4.2 billion.

We also take into account Specialfastigheter's strong market access in assessing its overall liquidity position, since 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 company has to waive dividend payments should its funding markets suddenly dry up.

Outlook

The stable outlook reflects our expectation that Specialfastigheter's very strong enterprise risk profile will support sustained strong EBITDA margins over the next two years, ensuring robust debt sustainability and strong internal liquidity. We also assume that Sweden will remain the sole owner of Specialfastigheter and the likelihood of extraordinary government support for the company will remain very high.

Downside scenario

The ratings could come under pressure if the company's link to, or role for, the government were to decline, for example if the government were to request that Specialfastigheter expand into business segments with lower public policy importance or announce a privatization of the company, which we consider unlikely. We could also take a negative rating action if the company's

SACP were to weaken, for example, due to a deterioration of its liquidity position stemming from looser financial risk management.

Upside scenario

We would 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 a strengthening of the SACP, for example thanks to significantly reduced debt, including a marked reduction of short-term debt that structurally strengthens the liquidity position and the resilience of the company's balance sheet.

Selected Indicators

Specialfastigheter--Key Statistics

| Mil. SEK | --Year ended Dec. 31-- | | | | |
|---|------------------------|----------|----------|----------|----------|
| | 2018a | 2019a | 2020e | 2021bc | 2022bc |
| Vacancy rates (%) | 1.0 | 1.7 | 1.5 | N.A. | N.A. |
| Revenue | 2,137.0 | 2,257.0 | 2,304.5 | 2,327.6 | 2,327.6 |
| EBITDA | 1,356.0 | 1,376.0 | 1,428.3 | 1,438.9 | 1,421.0 |
| EBITDA/revenue (%) | 63.5 | 61.0 | 62.0 | 61.8 | 61.1 |
| Interest expense | 97.0 | 114.0 | 119.8 | 127.7 | 140.0 |
| Debt/EBITDA (x) | 9.9 | 10.3 | 10.2 | 10.9 | 12.0 |
| EBITDA/interest coverage (x) | 14.0 | 12.1 | 11.9 | 11.3 | 10.1 |
| Capital expense | 721.0 | 834.0 | 875.0 | 1,614.2 | 1,891.5 |
| Debt | 13,401.0 | 14,117.0 | 14,544.5 | 15,690.4 | 17,017.9 |
| Housing properties (according to balance sheet valuation) | 27,288.0 | 29,037.0 | 30,116.8 | 31,945.9 | 34,063.1 |
| Loan to value of properties (%) | 49.1 | 48.6 | 48.3 | 49.1 | 50.0 |
| Cash and liquid assets | 35.0 | 305.0 | 305.0 | 305.0 | 305.0 |

SEK--Swedish krona. a--Actual. e--Estimate. bc--Base-case scenario. N.A.--Not available.

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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Affirmed

Specialfastigheter Sverige AB

| | |
|-----------------------|-----------------|
| Issuer Credit Rating | AA+/Stable/A-1+ |
| Nordic Regional Scale | --/--/K-1 |
| Commercial Paper | K-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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 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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