

Research Update:

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

December 16, 2021

## Overview

- We expect Specialfastigheter needs significantly higher capital expenditure (capex) to meet the acute demand for high security properties in the next few years, but its stable cash flow would offset risks related to debt increases.
- Specialfastigheter benefits from low risk in the public-sector property industry, 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.
- 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 very strong financial performance, ensuring robust debt sustainability and adequate liquidity.

## Rating Action

On Dec. 16, 2021, 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

Specialfastigheter owns and manages the majority of Sweden's prisons, as well as several juvenile detention centers, defense, and police authority properties. It operates in a low-risk industry with limited exposure to cyclicity. This has been further illustrated during the pandemic-triggered economic downturn, which has had a minimal impact on the company's operations and performance. All its tenants are state agencies, most of which provide services

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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.

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 stand-alone credit profile (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, underpinned by their public-policy mandate to provide properties for their owner governments' operations. We see the owner governments as actively involved in defining the company's strategy, while demonstrating a long-term commitment to compliance with goals and strategies, such as through appropriate capital withdrawals (dividends) and capital injections.

In September 2021, 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. Moreover, the majority of contracts contain clauses linked to the consumer price index, which offsets 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 also believe that Specialfastigheter benefits from having very few competitors, supporting robust demand for high-security properties.

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. We consider that Specialfastigheter's management team has sufficient expertise and long experience in the company's major operating segments. We also highlight some risk related to the upcoming high capex, which will create some challenges for management.

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 2021-2023 with EBITDA margins just below 60% on average. 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 to invest an average of about Swedish krona (SEK) 2.7 billion (about \$297 million) annually until 2023.

We currently do not expect Specialfastigheter to reduce its annual dividend payment to the central government, estimated at about SEK610 million over the coming three years. As a consequence, we expect there will be additional buildup of debt. We forecast the non-sales debt-to-EBITDA ratio at 14x in 2023, up from 10x in 2020. We expect EBITDA interest coverage will remain strong, benefitting from still low interest rates. Similar to other Swedish entities, however, the low interest cost is associated with significantly shorter debt duration compared with its investment cycles.

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 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.

## **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 SEK9.6 billion will cover uses of about SEK9.4 billion.

Sources include:

- Covered bond holdings of around SEK1.5 billion;
- Cash flow from operations of around SEK1.4 billion; and
- Undrawn contractually committed facilities of SEK6.8 billion expiring beyond 12 months.

Uses include:

- Capex on repairs and new development of SEK3.2 billion;
- Dividends of SEK0.6 billion; and
- Debt service (including interest costs) of about SEK5.7 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 central government owner is likely to waive dividend payments should there be any disruption of Specialfastigheter's access to funding.

Outlook

The stable outlook reflects our expectation that Specialfastigheter's stable cash flow will offset 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 up to 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 central government 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 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 resilience of the company's balance sheet.

## Key Statistics

Table 1

### Specialfastigheter Sverige AB--Key Statistics

Mil. SEK	--Year ended Dec. 31--				
	2019a	2020a	2021e	2022bc	2023bc
Vacancy rates (%)	1.7	1.5	1.5	N.A.	N.A.
Revenue	2,257.0	2,393.0	2,369.1	2,404.6	2,524.8
EBITDA	1,376.0	1,438.0	1,405.7	1,370.6	1,500.5
EBITDA/revenue (%)	61.0	60.1	59.3	57.0	59.4
Interest expense	114.0	126.0	151.7	173.7	201.3
Debt/EBITDA (x)	10.3	9.9	11.4	13.6	14.4
EBITDA/interest coverage (x)	12.1	11.4	9.3	7.9	7.5
Capital expense	834.0	801.0	1,560.0	3,164.0	3,469.9
Debt	14,117.0	14,282.0	16,063.5	18,676.3	21,577.1
Housing properties (according to balance sheet valuation)	29,037.0	29,618.0	31,418.0	34,857.8	38,581.1
Loan to value of properties (%)	48.6	48.2	51.1	53.6	55.9
Cash and liquid assets	305	332	331	331	331

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

## Ratings Score Snapshot

Table 2

### Specialfastigheter Sverige AB--Ratings Score Snapshot

Factor	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

Table 2

## Specialfastigheter Sverige AB--Ratings Score Snapshot (cont.)

Factor	Assessment
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

## 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.standardandpoors.com](http://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/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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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