

Research Update:

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

October 25, 2022

Overview

- Förvaltaren enjoys a highly predictable revenue stream from its rental housing activities, and it performs an important public policy role for the City of Sundbyberg.
- The company has sufficient financial headroom to cope with higher cost pressure and additional investments in its existing housing stock while developing new residential units.
- We affirmed our 'AA-/A-1+' and 'K-1' ratings on Förvaltaren.
- The stable outlook reflects our view that Förvaltaren has sufficient financial flexibility and management expertise to handle rising pressure on its financial metrics.

PRIMARY CREDIT ANALYST

Carl Nyrerod
Stockholm
+ 46 84 40 5919
carl.nyrerod
@spglobal.com

SECONDARY CONTACT

Erik A Karlsson
Stockholm
+ 46(0)84405924
erik.karlsson
@spglobal.com

Rating Action

On Oct. 25, 2022, S&P Global Ratings affirmed its 'AA-/A-1+' long- and short-term issuer credit ratings on Swedish public housing provider Fastighets AB Förvaltaren. The outlook is stable.

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

Outlook

The stable outlook reflects our view that Förvaltaren has sufficient financial flexibility and management expertise to adjust its operating and capital expenditures to mitigate pressure on its financial metrics.

Downside scenario

Ratings downside could stem from a pronounced weakening of Förvaltaren's financial metrics. This could occur if company management does not effectively address upcoming challenges, such as rising cost pressure, higher interest rates, and investment needs in refurbishment and new build.

Upside scenario

We could consider raising the ratings on Förvaltaren if we observed a material improvement in its financial position. This would include EBITDA margins of more than 30% thanks to improved cost controls, alongside liquidity coverage structurally higher than 1.25x. An upgrade could also occur if we see a strengthening in Förvaltaren's ownership or support structure that would make us positively reassess the company's role for, or link to, the City of Sundbyberg.

Rationale

The rating captures our view of Förvaltaren's stable rental housing operations and strong, risk-averse management focusing on core activities and robust financial metrics. We expect that Förvaltaren will maintain EBITDA margins of about 24% and forecast debt to non-sales adjusted EBITDA of 12.8x by 2024. The projections of modest profitability and higher debt incorporate our assumptions of inflation-driven cost pressures and continued investment in new-build and refurbishments. Förvaltaren maintains a strong liquidity position, underpinned by the group's ample liquidity sources consisting of cash, undrawn facilities, and strong access to external liquidity.

Förvaltaren's focus is on rental-housing properties, which we regard as a low-risk sector due to its stable and, to some extent, anticyclical revenue base. Demand for rental housing is very strong in Sundbyberg. Förvaltaren's housing vacancies are primarily related to apartments that are being emptied for renovations. Housing vacancies amounted to 2.9% in 2021 and is forecasted to decline to 2.0% by year-end 2022. We expect Förvaltaren's housing vacancies to decrease further over the coming years. This is because the company recently changed its approach from emptying apartments during refurbishments to offering the affected tenants a discounted rent in another unit.

Rising costs, caused by elevated inflation, have weighed on Förvaltaren's financial performance, but we expect the lagged rent increase to somewhat offset the cost increases. This leads us to forecast a slight weakening in Förvaltaren's EBITDA over 2022-2023, before it stabilizes at around 24% of revenue through 2024. We continue to adjust EBITDA for capitalized repairs, which we regard as an operating expense, averaging Swedish krona (SEK) 74 million in 2022-2024.

Förvaltaren's focus on new construction and increasing its portfolio of rental housing units remains firm, and we expect it will gradually ramp up capital expenditure (capex) over the coming years. It does not develop and sell property in the open market. In addition to spending on new construction, we expect the company will invest in existing housing stock related to refurbishments and maintenance. Consequently, Förvaltaren's debt is set to increase, likely reaching 12.8x of non-sales adjusted EBITDA by end-2024, according to our estimates. Furthermore, we assume that higher interest rates will somewhat constrain Förvaltaren's non-sales adjusted EBITDA interest coverage although it will remain strong at 4.3x at end-2024.

In our view, Förvaltaren's management is experienced and proactively manages the company's financial and operational risks. Over the years, the company has gradually decreased its exposure to commercial premises and increased its focus on refurbishments and developing its existing stock. Förvaltaren has a clear focus on delivering good quality public policy services for its tenants, and it enjoys strong customer satisfaction. Financial risks are monitored prudently, in line with its risk-limiting financial policies. That said, past shifts in strategies point to somewhat weaker governance by the city owner, Sundbyberg. Positively, the city's practices have become more balanced since the 2018 local elections, and we foresee no major shifts in Sundbyberg's

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steering of Förvaltaren over the coming four-year term.

We assess the regulatory framework for Swedish public housing companies as very strong, underpinned by our view that all city-managed rental housing in Sweden has a public policy role, with limited risk of negative government intervention. What's more, public housing companies employ reporting standards that are close to that for private companies. Tenants have the same rights in terms of rental negotiations, occupancy, and other terms and conditions, regardless of whether the landlord is from the private or public sector. Changes in the regulatory framework are rare, and when they occur, they are generally well prepared, with the major stakeholders involved in hearings and drafting responses.

In our view, Förvaltaren continues to benefit from a high likelihood of receiving timely and sufficient support from Sundbyberg if needed. Förvaltaren plays an important role as a key contributor of housing for the city's increasing population. Furthermore, we consider the link to Sundbyberg to be very strong. The city is the company's sole owner and is actively involved in defining Förvaltaren's strategies.

Liquidity

Förvaltaren's liquidity position rests on contracted and committed facilities, alongside our view of strong access to external liquidity. Förvaltaren has proven good access to capital market funding even amid market stress, and it benefits from the possibility to acquire bank loans backed by a municipal guarantee from its owner, City of Sundbyberg.

The company's liquidity sources cover uses by 1.19x over the next 12 months.

Liquidity sources include:

- Cash of about SEK157 million;
- Estimated operating cash flow of SEK180 million; and
- Committed and undrawn liquidity facilities of SEK1.11 billion.

Liquidity uses include:

- Expected capex of SEK385 million;
- Maturing debt and interest of SEK829 million; and
- Dividends of SEK2 million.

Table 1

Fastighets AB Förvaltaren--Key Statistics

Mil. SEK	--Year ended Dec. 31--				
	2020a	2021a	2022e	2023bc	2024bc
Number of units owned or managed	6,612	6,612	6,617	6,646	6,652
Adjusted operating revenue	719.0	723.9	756.4	797.8	836.4
Adjusted EBITDA	234.0	193.0	188.6	182.0	204.2
Non-sales adjusted EBITDA	234.0	193.0	188.6	182.0	204.2
Capital expense	329.0	393.7	433.6	369.5	568.6
Debt	1,600	1,800	2,100	2,185	2,610
Interest expense	23.0	14.1	21.5	29.2	47.9

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Table 1

Fastighets AB Forvaltaren--Key Statistics (cont.)

Mil. SEK	--Year ended Dec. 31--				
	2020a	2021a	2022e	2023bc	2024bc
Adjusted EBITDA/adjusted operating revenue (%)	32.5	26.7	24.9	22.8	24.4
Debt/non-sales adjusted EBITDA (x)	6.8	9.3	11.1	12.0	12.8
Non-sales adjusted EBITDA/interest coverage(x)	10.2	13.7	8.8	6.2	4.3

Note: Adjusted data is by S&P Global Ratings. SEK--Swedish krona. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Table 2

Fastighets AB Forvaltaren--Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	2
Market dependencies	3
Management and Governance	2
Financial risk profile	3
Financial performance	4
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

- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers
Published, June 8, 2021

Ratings List

Ratings Affirmed

Fastighets AB Forvaltaren

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