

Vacse AB (publ)

Rating Update

LONG-TERM RATING

BBB+

OUTLOOK

Positive

SHORT-TERM RATING

N-1+

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RATING RATIONALE

Our 'BBB+' long-term issuer rating on Vacse AB (publ) (Vacse) reflects the company's strong portfolio of modern, tailor-made properties leased on very long contracts (averaging around 10.3 years) to very creditworthy public-sector authorities that are essential to Sweden's public security. The rating also reflects the company's 100% occupancy rate and strong operating margins. It is supported by Vacse's strong financial position, low risk appetite and relatively moderate leverage: the company has a loan to value (LTV) ratio of 41.8%; an interest coverage ratio of 5.0x year to date (ytd); a low share of secured debt-to-assets (17%) as of 30 Sep. 2019; and a strong ownership profile.

These strengths are somewhat offset by Vacse's limited number of properties (15). Nordic Credit Rating (NCR) believes this concentration creates some risk at contract expiration, though this is low as only 7.1% of the total contract value expires within the next five years. In addition, the company has a high planned growth rate over the next few years, typically from pre-let development properties. Vacse has agreed to terms on a loan from Nordic Investment Bank (NIB) commencing in January 2020 which will diversify the company's funding and extend its average debt maturity to 3.6 years from 2.7 years.

OUTLOOK

The positive outlook reflects NCR's expectation that Vacse will finalise its largest development project, decreasing the company's portfolio risk significantly and improving its interest coverage further when tenants move in during 2020. It also reflects our expectation that Vacse will proactively extend maturing debt, maintain adequate liquidity buffers and keep LTV below 50%. The positive outlook could be revised to stable should the share of development properties not diminish as projected, leverage increases exceed expectations or the refinancing of upcoming debt maturities is delayed.

POSITIVE RATING DRIVERS

- Proactive refinancing of secured loan maturing April 2021
- EBITDA/net interest stabilising above 5.0x
- Successful completion of development projects

POTENTIAL NEGATIVE RATING DRIVERS:

- LTV ratio higher than expected, towards 50%
- Increased share of development projects where Vacse carries the associated risk

Figure 1. Vacse AB key credit metrics, 2015–2021e

SEKm	2016	2017	2018	2019e	2020e	2021e
Revenue	339	334	340	367	388	432
EBITDA	268	264	263	280	296	329
Investment properties	5,345	5,259	5,945	6,484	6,809	7,659
Net debt	2,338	2,046	2,416	2,695	2,871	3,541
Total assets	5,472	5,389	6,166	6,690	6,909	7,784
Debt/EBITDA (x)	8.7	7.7	9.2	9.8	9.7	10.8
EBITDA/interest (x)	3.9	3.9	4.1	4.6	4.7	4.7
LTV (%)	43.7	38.9	40.6	41.6	42.2	46.2

Based on NCR estimates and company data. e–estimate. All metrics are adjusted in line with NCR methodology.

COMPANY PROFILE

Operating environment
scores 'a'

Vacse was founded in 2009 by pension foundations associated with Apoteket AB, Atlas Copco AB, Ericsson AB, Sandvik AB, Skanska AB, Stora Enso AB and AB Volvo, the initials of which give Vacse its name. The company is a Swedish property provider focused on owning, managing and developing public-sector properties leased under long-term contracts to agencies of the Swedish government (mainly the police, prisons and courts administration) and municipalities. As of 30 Sep. 2019, the company's property portfolio consisted of 15 properties valued at SEK 6.4 bn.

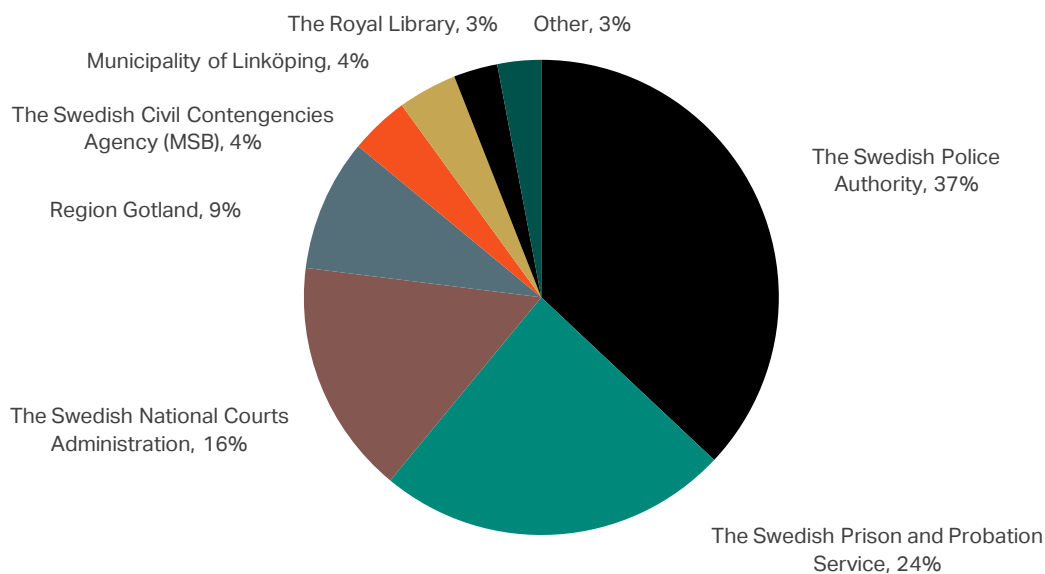
STRONG LONG-TERM DEMAND FOR PUBLIC-SECTOR PROPERTIES

Business risk adjustment
scores 'bbb+''

Our business risk assessment for Vacse reflects the stable operating environment in which the company operates, its low-risk property portfolio and very high operating efficiency.

NCR views the majority of Vacse's tenants as essential to Sweden's public security, and believes that the length of the company's lease contracts guarantees long-term relationships and stable rental income with low correlation with the economic cycle. We view all the company's tenants as highly creditworthy. Some 84% of the company's rental income is linked to the Swedish government, with the remaining 16% coming from several Swedish municipalities as of 30 Sep. 2019. Our understanding is that most political parties in Sweden are committed to increasing resources for the police and judiciary. We therefore expect the operating environment for Vacse to remain stable.

Figure 2. Vacse AB rental income by tenant, 30 Sep. 2019



SMALL BUT HIGHLY SPECIALISED AND DEFENSIVE PORTFOLIO

As of 30 Sep. 2019, Vacse's property portfolio consisted of 15 buildings totalling 152,300 sqm with an average contract lease length of about 10.3 years. As 86% of the properties are custom-built and highly specialised, there is a risk of not acquiring new tenants if contracts are not extended, which would result in a significant decrease in rental income and, consequently, property value. Leases have historically been renegotiated as Vacse's tenants typically remain in the same building for decades, and only 7.1% of its current contracted annual rental income matures within the next five years.

Having acquired an ambulance and fire station in Tierp in June 2019, Vacse is currently involved in five new development projects:

- Färagskrapan: a major 15,000 sqm development project in conjunction with existing company properties in Sollentuna (Attunda District Court). A 25-year rental contract for 60% of the property has been signed by the Swedish National Courts Administration and is expected to be finalised in two stages in 2020, at mid-year and year end.
- Jönköping: a signed purchase agreement for a 16,000 sqm office property which will house the Swedish Board of Agriculture and the Swedish Forest Agency in Jönköping. This is expected to be finalised in 2021 with 100% occupancy.
- Öckerö School Björkö: a signed purchase agreement for a 3,500 sqm school in Björkö. The property will have a contract of 25 years, a 100% occupancy ratio and is scheduled to be finalised 2021.
- Kungliga Bibliotek Håbo: following the maturity of a lease contract with the Royal Library in Håbo, the tenant both renewed the contract and entered an agreement under which Vacse will build an extension of 3,000 sqm to the current building. It is expected to be finalised in 2021 and will have a 25-year contract.
- District Court in Norrköping: a 4,000 sqm specialised building with a contract of 20 years. The project development is being conducted by Serneke Projektutveckling AB and is expected to be finalised in 2022.

Once finalised, these properties will expand Vacse's portfolio to 193,000 sqm by 2022, a 27% increase from the current total. These projects have increased the total share of development properties in Vacse's portfolio, which we believe is a risk factor. This, however, is mitigated by 86% of total development properties being pre-let, leaving only 3% of the total expected property portfolio in 2022 currently not contracted. New contracts typically have lease terms of 20–25 years with mostly highly creditworthy tenants.

The risks associated with these development projects are contingent on the structure of the respective acquisition. As Vacse is committed to the Jönköping and Öckerö School projects through purchase agreements, the company has no responsibility for these projects until they are completed and the tenants have started their lease period. Accordingly, we view the development risk in these projects as low. We assess the remainder of the development projects as carrying higher risk. The ongoing development projects amount to 12% of the future portfolio, with the Färagskrapan project accounting for 8%. We expect the majority of the Färagskrapan project (around 65%) to be finalised according to plan by mid-2020. The remainder of the project, some 5,000 sqm, is expected to be finalised during the second half of 2020 and the vacancy level is expected to be significantly reduced by end-2020. The initial occupancy by the court administration will reduce the development risk in Vacse's property portfolio and increase the company's rental income. Further, once the whole building is finalised, the risks associated with property development will be significantly reduced, in our view, to 4% of current market value.

The share of development projects and the associated uncertainty is a potential negative rating driver, as delays could lead to negative publicity, increased costs and heightened credit risk. Furthermore, we expect these projects to increase the company's leverage, with LTV estimated to increase to 42-46% and debt to EBITDA to 10.0–11.0x. This is, however, commensurate with our financial risk and ratio assessments as well as the overall rating on Vacse.

Figure 3. Vacse AB property portfolio, including development projects, 30 Sep. 2018

PROPERTY	LOCATION	TENANT	SQM
Kullen 1	Falun	The Swedish National Courts Administration	5,240
Rölunda 1:6	Håbo	The Royal Library	11,645
Tabellen 4	Sollentuna	Swedish Prison and Probation Service	19,070
Tabellen 3	Sollentuna	Swedish National Courts Administration	9,556
Rotorn 1	Flemingsberg	The Swedish Police Authority	13,152
Mörten 3	Södertälje	The Swedish Police Authority	7,800
Instrumentet 1	Linköping	Municipality of Linköping	7,395
Tjädern 9	Visby	The Swedish Police Authority	7,810
Visborg 1:15	Visby	Region Gotland	17,905
Mimer 3	Västervik	The Swedish Police Authority	3,857
Tvättbjörnen 1	Kalmar	The Swedish Police Authority	11,173
Vevaxeln 8	Malmö	The Swedish Police Authority	16,636
Flundran 2	Malmö	Swedish National Courts Administration	8,997
Kullen 1	Karlstad	Swedish Civil Contingencies Agency	12,852
Tierp	Tierp	Swedish Rescue Services Agency	3,200
Development projects			
Färgskrapan	Sollentuna	Swedish National Courts Administration	15,000
Jönköping	Jönköping	The Swedish Board of Agriculture and Forestry	16,000
Rölunda 1:6	Håbo	The Royal Library	4,000
Norrköping	Norrköping	The Swedish National Courts Administration	4,000
Björkö	Björkö	Municipality of Öckerö	3,500

Source: company data

As most of Vacse's properties are modern and highly specialised, typically with one long-term tenant, operating efficiency in terms of occupancy rates and EBITDA margins is very high. We expect Vacse to continue to operate with very high occupancy rates of close to 100%. We further expect the company's operating margins to remain above 75% as a result of negligible tenant turnover, modern properties and outsourced maintenance contracts.

FINANCIAL RISK ASSESSMENT

Compared with many of its Swedish real estate peers, Vacse has relatively modest leverage and strong net interest coverage. We view the company's overall financial policy and risk appetite as relatively prudent and include the strong ownership profile in our overall assessment of financial risk. We do, however, expect Vacse's leverage and LTV to increase somewhat as a result of the financing of new projects over the next two to three years, resulting in an LTV ratio of 42-46%. We find this ratio acceptable given the current financial risk assessment and overall rating. The secured loan from NIB will be paid out in January 2020 and carry a 10-year maturity at relatively low interest rate levels, supporting stable interest costs, despite somewhat higher debt levels over the next two to three years.

Financial risk
assessment scores 'bbb+'

Figure 4. Vacse AB financial targets, 30 Sep. 2019

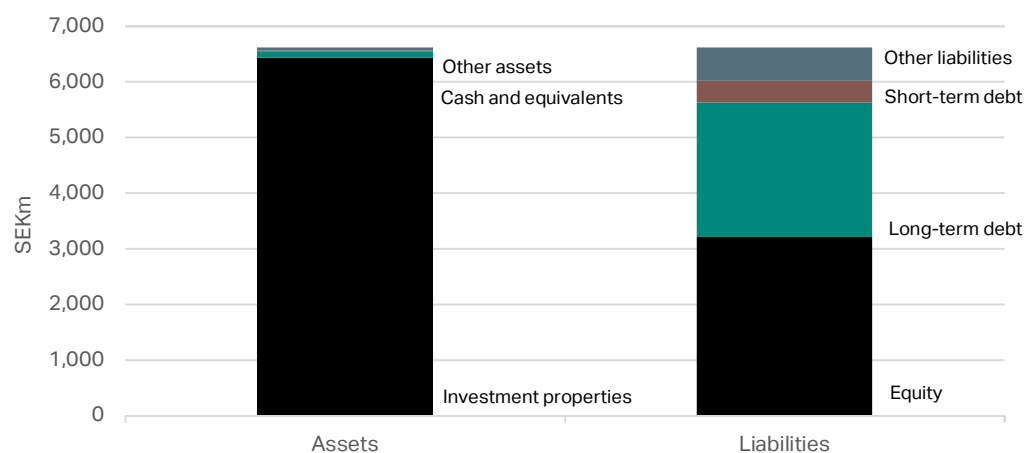
FINANCIAL POLICY	POLICY	30 SEP. 2019
Secured debt/total assets (%)	< 20	16.7
LTV (%)	< 50	41.8
EBITDA/interest (x)	> 2	5.0*
Average debt maturity (years)	> 2	2.7

Source: company data. *ytd.

We expect Vacse's main sources of future funding to be unsecured debt, with secured debt remaining below 20% of total assets, in line with company policy. The NIB loan commencing in Jan. 2020 will replace a current secured and utilised revolving credit facility and keep Vacse's secured debt to total assets ratio at around 17%. As a result of converting a shareholder loan of SEK 1.454m to common equity in December 2018, the company made a first dividend pay-out of SEK 70m in 2019, and we expect similar future dividend payments.

We make no adjustments to reported figures in our calculation of credit metrics. Vacse's balance sheet structure can be seen in Figure 5.

Figure 5. Vacse AB balance sheet, 30 Sep. 2019



Source: company data

In our base-case scenario, we assume the following:

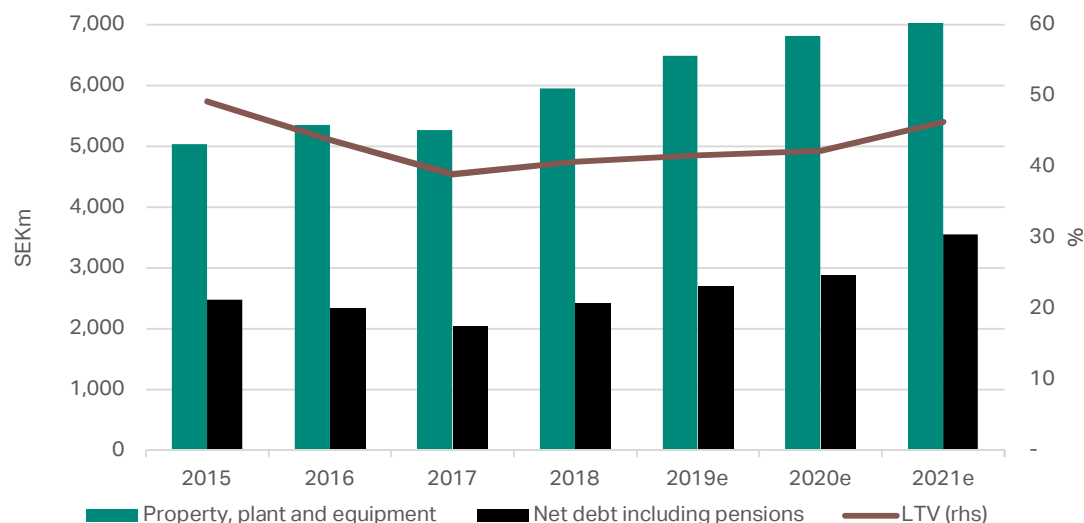
- Rental income growth of 8% in 2019, 6% in 2020 and 11% in 2021, with growth mainly resulting from the leasing of new space and completion of existing projects.
- EBITDA margin to remain above 75%.
- Interest costs on external debt of around SEK 60m a year in 2019 through 2021.
- Investments in existing properties and new projects of about SEK 300m in 2020 and SEK 850m in 2021.
- No increase in the value of the existing portfolio, only an increase from new projects being finalised.

Based on these assumptions, we arrive at the following for 2019–2021:

- LTV of 42-46%;
- EBITDA to net interest of above 4.5x; and
- debt to EBITDA of 10–11x.

As shown below, we expect Vacse's gross debt and LTV to increase somewhat over the next few years as a result of new investment and stable valuation of existing properties.

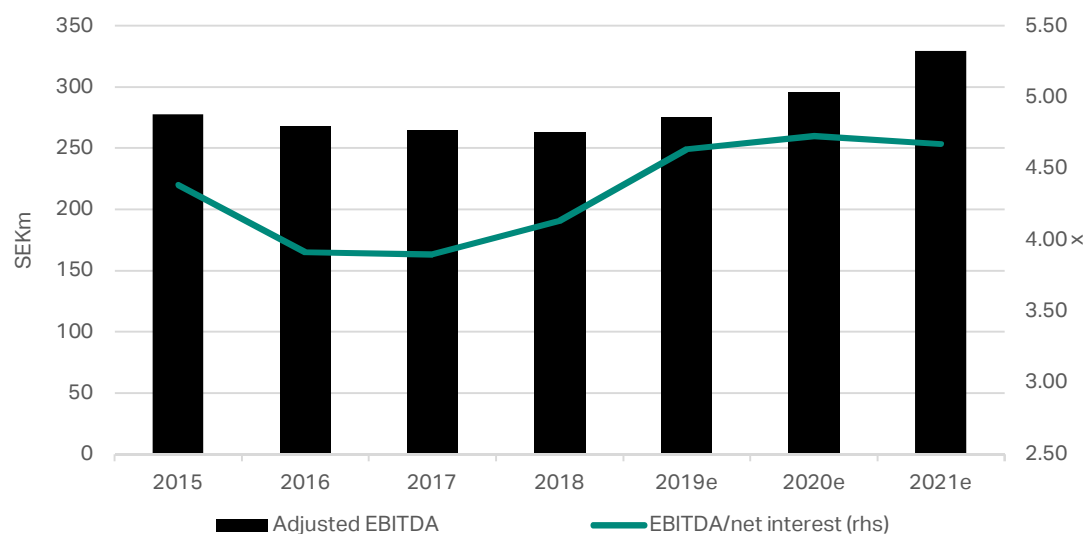
Figure 6. Vacse AB net debt, property value and LTV



Source: company data, e-estimate.

However, due to the lower cost of borrowing, we expect EBITDA/net interest to increase despite the rise in total debt.

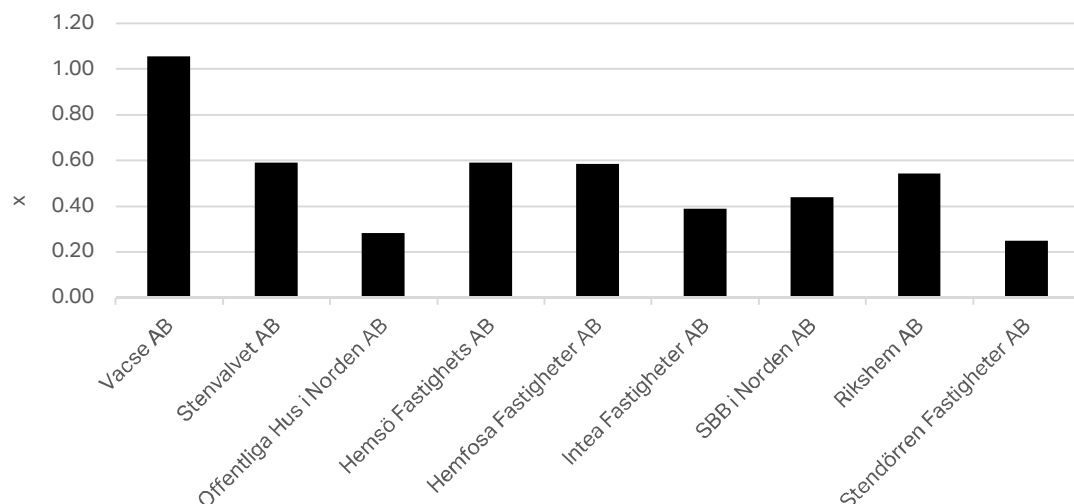
Figure 7. Vacse AB EBITDA and EBITDA/net interest



Source: company data, e-estimate.

While projected net debt/EBITDA of 10-11x weighs negatively on our assessment of Vacse's financial risk, the risk is mitigated by the company's long remaining average lease term. As shown in Figure 8, Vacse is the only issuer among its nearest peers with existing contracts exceeding net debt/EBITDA. This reflects the theoretical ability for Vacse to repay existing debt with existing contracts. Combined with the high share of government-related tenant revenues, this supports our view that the company's risk appetite is somewhat stronger than its financial ratios and its portfolio quality less dependent on both size and macroeconomic cycles than many of its peers.

Figure 8. Vacse AB and peers' average remaining lease term vs net debt/EBITDA*



Source: company data, e-estimate.

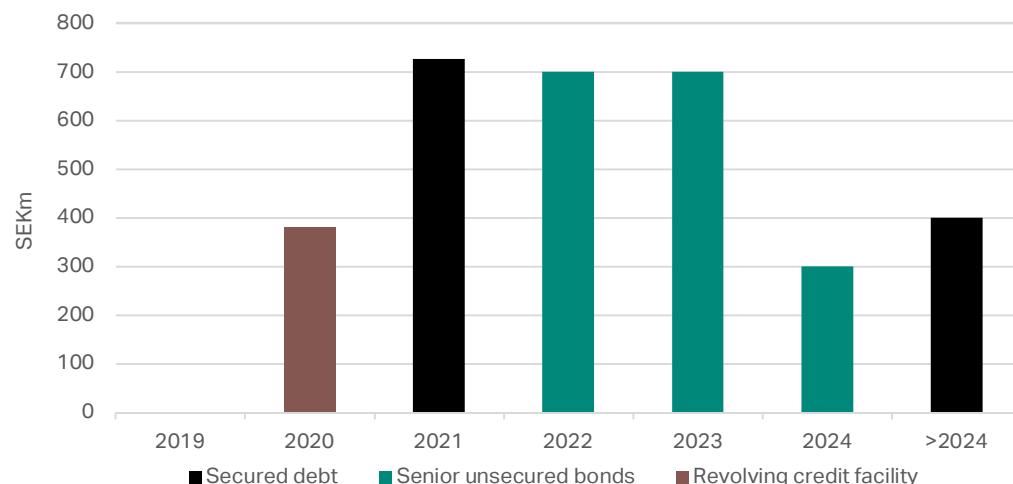
*Data as of 30 Sep. 2019 where available, otherwise 30 Jun. 2019

Vacse was created to provide its owners with long-term low-risk returns. Following relatively rapid growth between 2011 and 2015, the current management has been prudent in its approach to growth and financing, in our view. Due to relatively high property prices in Sweden, including in the public sector, Vacse is focused on controlled growth and lowering its financial risk, which we believe is also the objective of the company's owners. We view the lengthening of the average debt maturity profile as positive in terms of credit risk. Accordingly, Vacse's overall risk appetite supports our view of the company's financial risk profile.

LIQUIDITY PROFILE

We assess Vacse's liquidity profile as adequate after the company secured refinancing of a revolving credit facility maturing next year with the 10-year NIB loan. As part of a more prudent financial strategy, management is expected to work actively to extend the company's debt maturity profile and seek funding for the planned portfolio increases in the next few years, as well as a secured bank loan maturing in 2021, while maintaining its liquidity buffers.

Figure 9. Vacse AB debt maturity profile, 30 Sep. 2019



Source: company data

Our assessment is supported by Vacse's good access to multiple capital sources and a satisfactory standing in the capital markets. This has been demonstrated by several successful bond issuances in

the first half of 2019 (totalling SEK 600m in green bonds); its good relationship with major Swedish banks; and the support of its owners, which have historically injected funds into the company. Vacse also has a SEK 600m revolving credit facility with Svenska Handelsbanken of which SEK 100m matures on 11 Dec. 2019 and SEK 500m of which matures on 11 Dec. 2020. As of 30 Sep. 2019, the company had utilised SEK 380m of this facility, which we expect to be refinanced by the NIB loan.

We estimate the following primary liquidity sources for the next 12 months as of 30 Sep. 2019:

- cash and equivalents of SEK 113m;
- a SEK 400m secured loan from NIB with a 10-year tenor;
- a SEK 500m committed credit facility maturing in 2020; and
- funds from operations, which we expect to be SEK 225m.

We anticipate liquidity to be used for the following over the next 12 months:

- amortisation of secured debt of SEK 25m in 2019;
- a SEK 380m maturing revolving credit facility;
- a dividend pay-out of SEK 70m; and
- planned investment of SEK 275m.

As sources outweigh uses of liquidity, we believe that the company has sufficient liquidity over the next 12 months.

ESG

Overall, Vacse's environmental, social and corporate (ESG) governance policies enhance our view of the company's overall business risk and competitive position. The company has demonstrated a commitment to environmental issues with certification targets for its new and existing property portfolio, which we view as increasingly important for its government-related tenants. In 2018, Vacse developed a green bond framework aligned with the UN's sustainable development goals and has been accorded "Medium Green" status in a Second Opinion from CICERO, the Centre for International Climate Research. Within this framework, Vacse has issued debt of SEK 1.7m. The NIB requires BREEAM Excellent certification as a condition of its 10-year loan. Vacse's focus on certification could provide the company with further debt diversification opportunities and enhance the likelihood that its properties will retain asset values over time, thereby facilitating renegotiation of contracts at maturity.

Most of Vacse's properties are associated with social stability and include prisons, police departments and courts. In this respect, the company caters to global megatrends such as demographic shifts and population growth. Continued population growth in Sweden coupled with increased immigration could result in a need for greater judicial strength and access to judicial services. To promote social responsibility, Vacse runs a programme supporting foreign post-graduate students. In our understanding, the company places an emphasis on its reputation as a good employer and landlord. We see little risk of change, conflicts or other governance-related issues in connection with the current management, board or owners.

SUPPORTING OWNERSHIP STRUCTURE

We view Vacse's ownership structure, shown in Figure 10, as supportive of the company's low-risk strategy and solid financial position, which we factor into our assessment via the financial risk profile and overall rating on the company. Vacse's owners are pension foundations associated with a number of well-known Swedish blue-chip companies. Supporting factors include the following:

- Vacse's owners are financially strong and, we believe, committed for the long term.
- Vacse is integral to the owners' long-term investment policy.
- A change-of-control clause stipulates that the company's bonds must be repaid in full if the current group of owners were to have less than 50% ownership.
- Committed equity capital of SEK 2.8bn in funding, of which 1.1bn is unutilised.
- A history of the owners injecting funds into the company.

Figure 10. Vacse AB ownership structure, 30 Sep. 2019

OWNER	SHARE
Ericsson Pensionsstiftelse	21.4%
Skanska Trean Allmän Pensionsstiftelse	21.4%
Apoteket AB:s Pensionsstiftelse	14.3%
AB Volvo Pensionsstiftelse	14.3%
Atlas Copco-Group Gemensamma Pensionsstiftelse	10.7%
Stora Enso Svenska Gemensamma Pensionsstiftelse	10.7%
Sandvik Pensionsstiftelse i Sverige	7.1%

Source: company data

Figure 11. Scoring summary sheet

Subfactors	Impact	Score
Operating environment	20.0%	a
Market position, size and diversification	12.5%	bb-
Portfolio assessment	12.5%	a-
Operating efficiency	5.0%	aa
Business risk assessment	50.0%	bbb+
Ratio analysis		bbb+
Risk appetite		a-
Financial risk assessment	50.0%	bbb+
Indicative credit assessment		bbb+
Liquidity		-
ESG		-
Peer comparison		-
Standalone credit assessment		bbb+
Support analysis		-
Issuer rating		BBB+
Outlook		Positive
Short-term rating		N-1+
Issue rating indication	Starting point	Issue rating
Senior unsecured	Issuer rating	BBB+

Figure 12. Financial statement 2015-2021e

SEKm	2015	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT							
Revenue	336	339	334	340	367	388	432
Cost of goods sold	-43	-46	-49	-54	-62	-66	-73
Sales, general & admin. expenses	-15	-25	-21	-23	-25	-26	-29
EBITDA	277	268	264	263	280	296	329
Interest costs	-63	-69	-68	-64	-60	-63	-71
Interest on shareholder loans	-88	-89	-88	-81			
Change in value of properties	170	301	162	267	124	0	0
Change in value of financial instruments	33	-23	13	-1	-54	0	0
Pre-tax profit	328	389	284	384	290	233	259
Current tax	-5	-1	-3	-1	-1	-0	-0
Deferred tax	-67	-60	-56	-66	-30	0	0
Net Profit	256	328	224	318	259	233	258
BALANCE SHEET							
Property, plant and equipment	5,025	5,345	5,259	5,945	6,484	6,809	7,659
Other non-current assets	0	0	0	1	1	1	1
Total non-current assets	5,025	5,345	5,259	5,946	6,485	6,810	7,660
Cash and cash equivalents	46	106	92	188	174	68	92
Other current assets	64	21	39	32	32	32	32
Total current assets	110	127	130	220	206	100	124
Total assets	5,135	5,472	5,389	6,166	6,690	6,909	7,784
Total equity	772	1,100	1,324	3,096	3,285	3,448	3,637
Long-term interest-bearing loans	1,397	2,137	2,130	1,824	2,464	2,188	2,914
Shareholder loans	1,454	1,454	1,454				
Other long-term liabilities	237	320	348	324	382	382	382
Total non-current liabilities	3,088	3,910	3,932	2,148	2,846	2,570	3,296
Total current liabilities	1,275	461	132	922	559	891	852
Total equity and liabilities	5,135	5,472	5,389	6,166	6,690	6,909	7,784
CASH FLOW STATEMENT							
Pre-tax profit	328	389	284	384	290	233	259
Cash flow before changes in working capital	119	91	98	130	231	244	270
Changes in working capital	-36	61	-23	7	0	0	0
Operating cash flow	83	153	75	137	231	244	270
Cash flow from investing activities	-89	-19	218	-415	-415	-325	-850
Cash flow from financing activities	-29	-74	-308	375	170	-25	605
Cash and cash equivalents beginning of the year	81	46	106	92	188	174	68
Cash flow for the year	-35	60	-15	96	-14	-106	25
Cash and cash equivalents at the end of the year	46	106	92	188	174	68	92

Based on NCR estimates and company data. e-estimate. All metrics are adjusted in line with NCR methodology

Type of credit rating:	Long-term issuer credit rating Short-term issuer credit rating Issue credit rating
Publication date:	The rating was first published on 25 Oct. 2018.
Office responsible for the credit rating:	Nordic Credit Rating AS (NCR), Oslo, Norway. NCR is a registered credit rating agency under Regulation (EC) No 1060/2009.
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Methodology used when determining the credit rating:	Nordic Credit Rating - Corporate Methodology published 14 Aug. 2018 Nordic Credit Rating - Rating Principles published 16 Sep. 2019 The methodology and principles documents provide analytical guidance to NCR's rating activities including but not limited to, assumptions, parameters, cash flow analysis, and stress-testing. NCR's methodologies and principles can be found on our website nordiccreditrating.com/governance/policies . The historical default rates of entities and securities rated by NCR will be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA) .
Materials used when determining the credit rating:	Annual- and quarterly reports of the rated entity, Bond prospectuses, Company presentations, Data provided by external data providers, External market reports, Meetings with management of the rated entity, Non-public information, Press reports/public information, Website of rated entity
Conflicts of interest:	The rating is NCR's independent opinion of the rated entity's relative creditworthiness. The rating is solicited, i.e. it is prepared for a fee paid by the rated entity. At the time of analysis and publication neither NCR nor any of the analysts or persons involved in the rating process held any interest, ownership interest or securities in the rated entity.
Additional information:	Prior to publication, the rating was disclosed to the rated entity. The issuer was given 24 hours (of which 8 business hours) to remark on factual errors and/or the inadvertent inclusion of confidential information, if applicable. The rating was not amended after the review by the issuer. No stress test was performed. Standard cash flow forecasting was performed. NCR's rating is an opinion regarding the relative creditworthiness of an entity or an instrument. It is not a prediction, guarantee or recommendation to buy, hold or sell securities. NCR assigns outlooks to issuer ratings to indicate where they could move in the near term, normally 12–18 months. Further information on the rating process, rating definitions and limitations is available on our website: nordiccreditrating.com/governance/policies .
Ancillary services provided:	No ancillary services were provided.
Regulations:	This rating was issued and disclosed under Regulation (EC) No 1060/2009.
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