Nordic Credit Rating

CORPORATE

Offentliga Hus i Norden AB (publ)

Sweden
Real estate management

2 Sep. 2019
Rating initiation

LONG-TERM RATING

BB-

OUTLOOK

Stable

SHORT-TERM RATING

N-2

PRIMARY ANALYST
Mille O. Fjeldstad
+47 990 38 916
mille.fjeldstad@nordiccreditrating.com

SECONDARY ANALYST
Michael Andersson
+46 732 324 322
michael.andersson@nordiccreditrating.com

RATING RATIONALE

Our 'BB-' long-term rating on Sweden-based public service property provider Offentliga Hus i Norden AB (publ) (Offentliga Hus) reflects the company's strong property portfolio and long-term contracts averaging over 5 years. Offentliga Hus' tenants are mostly highly creditworthy and include government bodies and municipalities (67% of the company's rental income comes from public-sector tenants and a further 19% from private-sector tenants typically within the health and care segment and indirectly funded by the government). The rating further reflects the company's geographically diverse portfolio, stable operating efficiency and 4% vacancy ratio.

Offsetting these strengths are Offentliga Hus' relatively high level of secured debt and corresponding interest expense which led to an adjusted net interest coverage ratio of 1.6x, a loan-to-value (LTV) ratio of 61% and a debt-to-EBITDA ratio of 20x as of 30 Jun. 2019. The rating is further affected by a one-notch downward adjustment to reflect uncertainty about the financing of Offentliga Hus' ambitious growth plans, given the company's history of expansion and the owners' aim to conduct an initial public offering in the next few years.

OUTLOOK

The stable outlook on Offentliga Hus reflects our view that the company will maintain a stable mix of properties and tenants, despite its ambitious expansion plans. We further expect the company to proactively refinance its upcoming debt maturities and continue to fund its new investments in line with its LTV target of 60%. The outlook further reflects the stable economic outlook for the community service sector in Sweden.

POSITIVE RATING DRIVERS:

- A sustainable increase in net interest coverage to increase headroom within the company's bond covenants
- Clear growth strategy with stable and sustainable financing
- Focus on tier 1 quality properties with desirable LTV level

NEGATIVE RATING DRIVERS:

- Any corrosion in financial metrics
- A deterioration in the macroeconomic environment could affect revenues, property values and covenant headroom
- Breaching covenants could have a multi-notch negative impact on the rating if liquidity is compromised

Figure 1. Key credit metrics for Offentliga Hus, 2015 – 2021e

SEKm	2015	2016	2017	2018	2019e	2020e	2021e
Revenue	94	116	135	208	339	370	379
EBITDA	61	81	88	113	204	226	231
Investment properties	1,544	1,622	2,396	3,932	5,893	6,260	6,260
Net debt	979	985	1,381	2,429	3,628	3,894	3,795
Total assets	1,577	1,673	2,791	4,266	6,316	6,555	6,588
Debt/EBITDA (x)	16.0	12.1	15.7	21.5	17.8	17.2	16.4
EBITDA/interest (x)	3.0	4.0	3.2	1.6	1.8	1.8	1.8
LTV (%)	63.4	60.7	57.7	61.8	61.6	62.2	60.6

Based on company data and NCR estimates. e–estimates.

COMPANY PROFILE

Founded in 2011, Offentliga Hus focuses on acquiring public properties to lease back to the public sector. The company is owned equally by AB Fastator (publ) (Fastator), whose largest investment is Offentliga Hus, and Offentliga Nordic Property Holding S.A.R.L., a holding company majority owned by a Swiss family office with long-term investments throughout Europe. Offentliga Hus has only two employees and outsources its remaining functions to Nordic PM, a property management company majority owned by Fastator. Offentliga Hus has grown rapidly since its inception and currently has 213 properties totalling 367,000 sqm with a market value of SEK 4.7bn. The company has a stated goal of listing within the next few years.

STABLE DEMAND FOR COMMUNITY SERVICE SEGMENT PROPERTIES

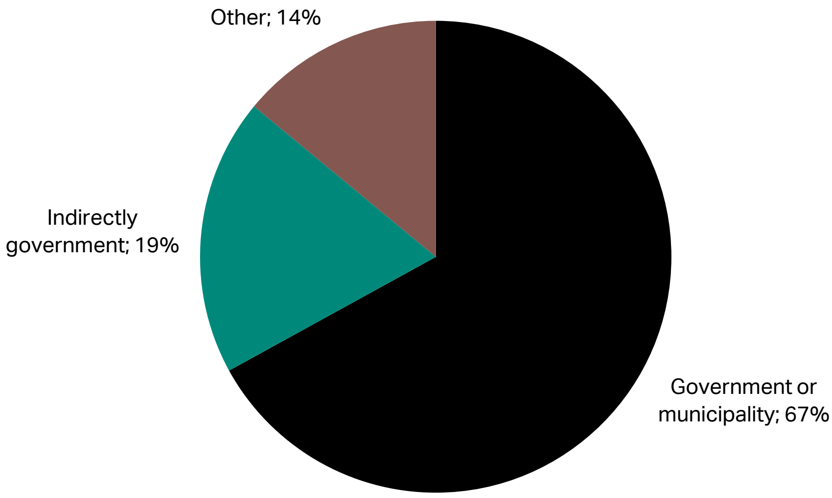
Our 'bbb-' business risk assessment for Offentliga Hus reflects the company's stable operating environment, its existing portfolio quality and operating efficiency. Offentliga Hus holds properties mainly within the community service segment. Its tenants are mostly publicly financed bodies such as local governments and municipalities, which generated about 67% of its rental revenue as of June 2019. Commercial tenants indirectly funded by government or municipalities, such as private health and care providers, account for 19% of revenues. Furthermore, a large part of the portfolio by area consists of specialised health and care facilities (37%) and schools (18%), segments which we believe will see continued government focus.

Sweden has a mature economy with low unemployment and high productivity, and there is widespread political acceptance that community services will require more investment due to the country's increasing population, which is expected to continue to show strong growth, especially within the age groups above 75 and below 20. As the dependent part of the population grows, municipalities face increasing pressure in areas such as health and care, schools and nursing homes. The low unemployment level means that there is limited possibility to increase municipal tax revenues unless tax rates are increased. Accordingly, increasingly debt-laden municipalities must review their investments. This effectively supports Offentliga Hus' business model and we expect the operating environment to remain stable.

SMALL BUT DIVERSE PORTFOLIO

Offentliga Hus had 213 properties worth SEK 4.7bn occupying 367,000 sqm across Sweden as of 30 Jun. 2019. The company significantly increased its portfolio in 2018, mainly through a large purchase from Svevia AB, and has continued to grow through 2019 with a focus on the community service segment. As of 30 Jun. 2019, a total of 86% of the current revenue was directly or indirectly associated with the Swedish government and municipalities (see Figure 2).

Figure 2. Rental revenue by segment, 30 Jun. 2019

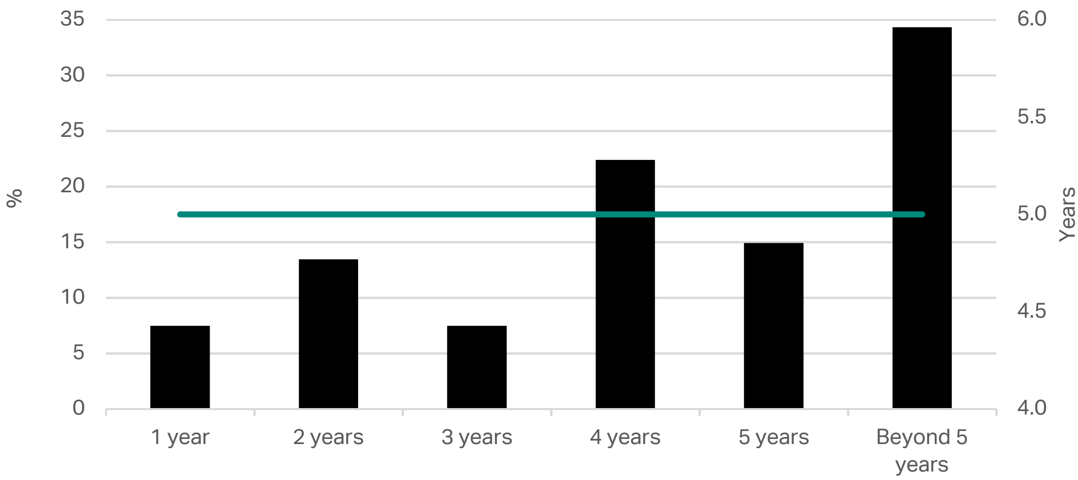


Source: Company data

The average remaining lease-term was 5 years as of 30 Jun. 2019, with 7% of leases maturing within the subsequent 12 months, while some 35% had an average remaining lease-term of more than 5 years.

A large part of the property portfolio consists of specialised properties such as schools and health care and road maintenance facilities. In our view, the risk that rental contracts for such properties will not be renewed on expiry is low. Some 27% of the portfolio consists of office space, which we believe presents more of a renewal and refurbishment risk. The company has an economic occupancy rate of 96%, while the vacant leasable area corresponds to 8% of the total portfolio. We do not expect the occupancy rate to deteriorate due to new properties in the pipeline. The current lease-term structure can be seen in Figure 3.

Figure 3. Rental revenue maturities and average remaining lease term as of 30 Jun. 2019



Source: Company data

An increasing share of Offentliga Hus' recent acquisitions have been in densely populated regions. The new properties will increase the company's share of revenues from government and municipal tenants. In June 2019, the company acquired a 61,000 sqm property in Södertälje for SEK 715m. Tenants include KTH Royal Institute of Technology and Södertälje municipality and the property has an average remaining lease-term of 6 years. In addition, Offentliga Hus has signed purchase agreements totalling about SEK 1.1bn which will take effect in the fourth quarter of 2019. The properties have a total occupancy ratio of 95%. For 2020, Offentliga Hus has signed an agreement to acquire a property under development in Gothenburg for SEK 367m, subject to a minimum occupancy rate of 90%, which we assess as risk-positive for the company. At present, 80% of the property is occupied by community service tenants with lease terms of 10-15 years. We have not speculated about the size, timing or funding of prospective acquisitions other than those already made public, but we believe that future growth could be materially higher than at present, with a significant impact on the company's credit metrics.

We expect Offentliga Hus' property portfolio to total SEK 5.8bn by the end of the year, once all contracted properties are within the company's possession. These acquisitions will be financed by debt and equity resulting in the company's LTV ratio remaining at around 62% through 2020 by our estimates, depending on the exact financing mix.

The top 10 tenants represented less than one-third of the property portfolio as of 30 Jun. 2019 (see Figure 4). We estimate that, by end-2019, the recently signed contracts will help to diversify the company's lease maturity profile and tenant base.

Figure 4. Top ten tenants as of 30 Jun. 2019, rent value

TOP 10 TENANTS
Svevia AB
Swedish Police
Värmland Region
Skåne Region
Borås City
Nytida Solhaga By AB
KTH Royal School of Technology
Sameskolan
Gotland Region
Scania CV AB

Source: Company data

FINANCIAL RISK ASSESMENT

Our 'b' financial risk assessment of Offentliga Hus reflects the company's weak financial metrics, high leverage and rapid growth. We project adjusted LTV of about 61-63%, an adjusted EBITDA to net interest ratio of 1.8x, and adjusted debt to EBITDA of 16-17x for 2019 through 2021. Our assessment further reflects our expectations that the company will continue to grow and comply with its covenants (see Figure 5), despite our view that it has a high risk appetite.

Figure 5. Financial covenants for the senior unsecured bond

COVENANTS	UP UNTIL 31 DEC 2019	FROM 31 DEC 2019	NCR ESTIMATES* 2019E -2020E
Minimum equity ratio (%)	25	30	32-34
Maximum LTV ratio (%)	75	70	61-63
Minimum interest coverage ratio (x)	1.5	1.5	1.8
Minimum total equity SEK	625m	625m	2,050-2,250m

Source: Stamdata, *NCR adjusted metrics

The company recently tightened its financial policy, lowering its target LTV to 60%, which is well below the 70% level (as of 31 Dec. 2019) stipulated in its financial covenants. Given the company's growth plans we do not expect it to deleverage at a significant rate and expect the LTV to remain at about or slightly above 60% through 2021.

As of 30 Jun. 2019, Offentliga Hus held SEK 3bn in interest bearing debt, of which SEK 700m represented senior unsecured bonds maturing in 2021. The remaining 76% consists of secured bank debt. The company has established relationships with several banks and a history of securing most of the necessary funding before engaging in property acquisitions via local banks interested in financing local properties. We view the diversity of the company's bank contacts and use of local banks as supportive of prospective refinancing and positive in terms of reducing liquidity risk. The company uses interest rate swaps to hedge some of its risk exposure to floating interest rates.

In our base case, we assume the following:

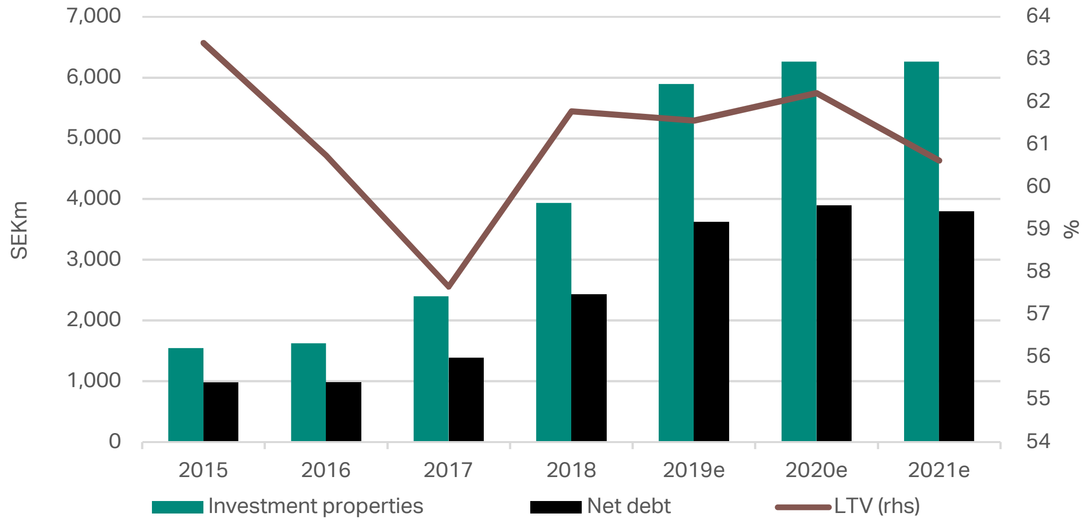
- Rental income growth of 59% in 2019, 9% in 2020 and 2.5% in 2021;
- EBITDA margin remaining at about 60% for the next three years;
- Interest costs, including interest rate swaps, amounting to SEK 113m in 2019, SEK 129m in 2020 and SEK 133m in 2021;
- Investments in properties of SEK 1.9bn in 2019 and SEK 400m in 2020;
- No valuation changes in current property values; and
- Increased external financing during 2019 in conjunction with a planned purchase worth SEK 1.1bn in the fourth quarter of 2019.

Based on these assumptions, we estimate the following metrics for 2019-2021:

- Adjusted LTV of 61-63%;
- Adjusted EBITDA to net interest of about 1.8x; and
- Adjusted debt to EBITDA of about 16-17x.

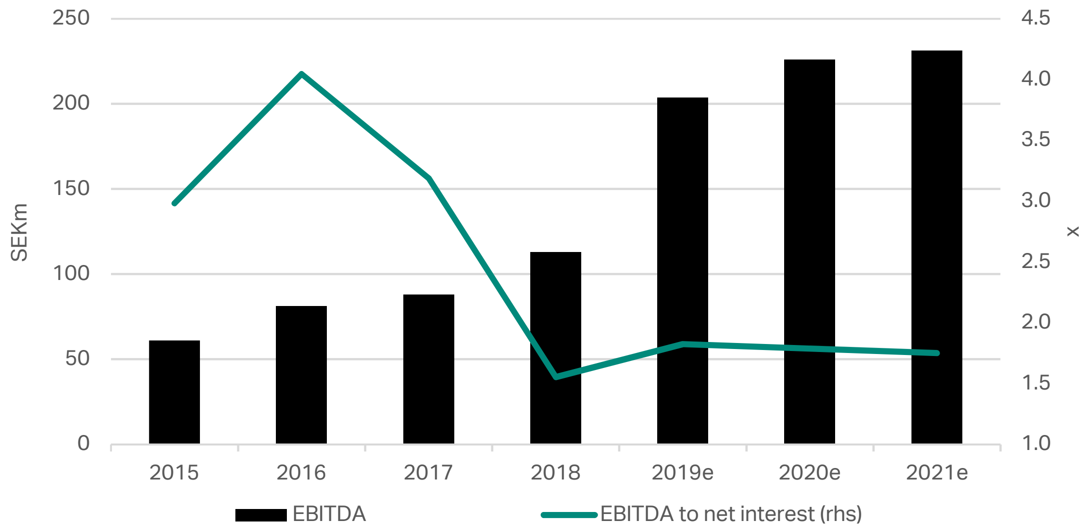
Based on the company's growth and funding plans, we expect LTV to remain at its current level over the next few years (see Figure 6). As previously noted, we assume no value changes to the investment properties in this period. Offentliga Hus held debt totalling SEK 3bn as of 30 Jun. 2019. We estimate that total outstanding debt will increase to SEK 3.6bn by the end of 2019, of which 75% will be secured. In our view, the high share of encumbered assets will limit recovery prospects for unsecured bond holders.

Figure 6. Property values, net debt and LTV, 2015 – 2021e



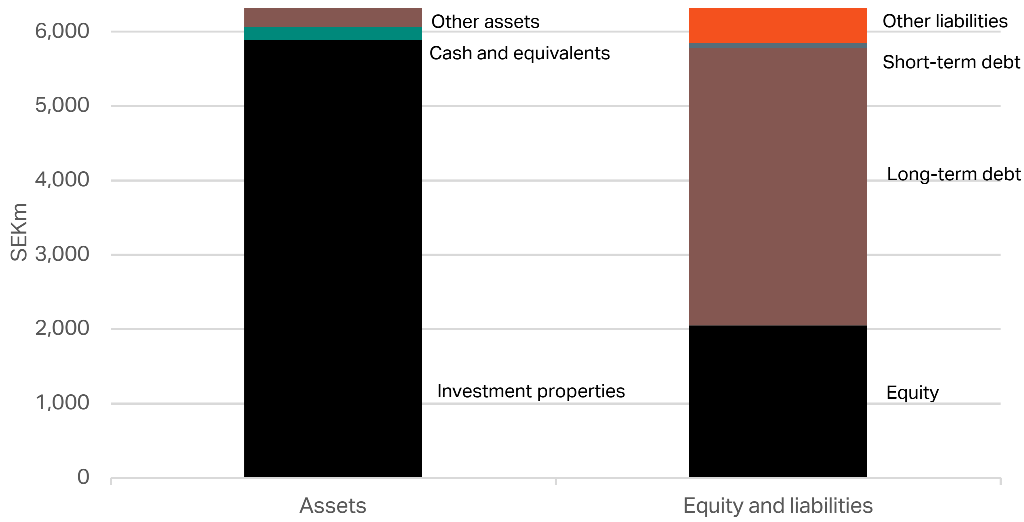
Source: Company data

Figure 7. EBITDA and EBITDA to net interest, 2015 – 2021e



Source: Company data

Figure 8. Estimated balance sheet, 2019e



Source: Company data

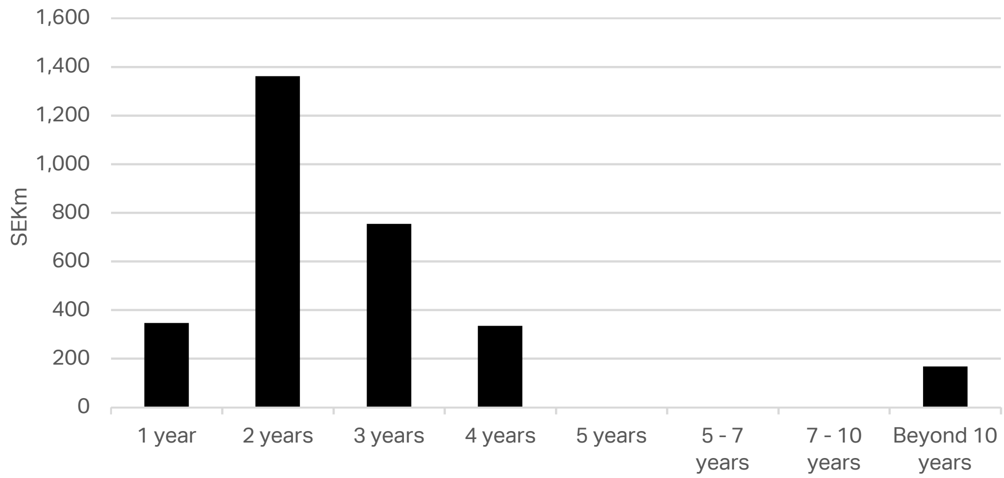
LIQUIDITY ANALYSIS

We assess Offentliga Hus' liquidity profile as adequate despite the large commitments arising over the next 12 months due to purchases totalling SEK 1.5bn. Further, some SEK 350m in maturing debt must be refinanced during the next year. The company has no revolving credit facilities or commercial paper, and a bond maturing in 2 years has been fully tapped.

We expect the new properties to be funded by secured bank debt with a maximum LTV of 55%, equity and market financing. Accordingly, we expect these needs to be met, in view of the company's close relationship with its owners, and its relationships with banks and investment banks.

Some 46% of Offentliga Hus' debt matures in the next 12-24 months, and we expect the company to be proactive as it approaches these maturities and extends its funding profile.

Figure 9. Debt maturities as of 30 Jun. 2019



Source: Company data

ADJUSTMENT FACTORS

According to our criteria, the adjustment factor 'peer calibration' can be utilised when there are either direct peer group comparison adjustment needed or if there are other uncertainties that could affect the rating in either positive or negative direction. We use the peer calibration factor to notch Offentliga Hus down by one notch from our indicative credit assessment due to other uncertainties. We recognise that the company has growth ambitions, but, as indicated earlier, have not speculated about the size or timing of future purchases or the likely funding mix. We adjust the indicative credit assessment downwards by one notch to reflect this uncertainty. As the company evolves, we expect to see a more transparent financial strategy.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE FACTORS

Offentliga Hus does not currently report publicly on environmental, social or governance (ESG) issues. Nor does the company report on emissions, sourcing or usage of materials, or any environmental certifications. However, the commercial real estate sector is a net consumer of energy and materials and produces substantial waste and many other Swedish property managers have acquired either the Swedish Environmental Building Certification, or international certifications such as LEED or BREEAM to attract or maintain tenants. Upgrading properties to qualify for such certifications could be costly but might be expected by tenants seeking to renew leases. We deem the ESG factor relevant in our overall assessment as it could affect future margins but have chosen to not notch the rating down in this respect. However, we note that it could affect the attractiveness of Offentliga Hus' properties and so become a negative rating factor in the longer run.

OWNERSHIP STRUCTURE

Offentliga Hus is owned 50% by Fastator and 50% by Offentliga Nordic Property Holding S.A.R.L., a Luxembourg-based company owned 75% by a Swiss family office and 25% by an individual, who also sits on the board of directors. Under the company's bond covenants, the dividend paid to the owners is capped at 50% of the previous year's profit before value changes and after tax and is subject to an equity ratio of above or equal to 25%. The board of directors further consists of two former politicians, Fastator's COO and one of Fastator's board members. Despite capital injections to support growth, we take the view that the aim of listing the company over the coming years reduces the likelihood of explicit ownership support in the rating.

Figure 10. Scoring summary sheet

Subfactors	Impact	Score
Operating environment	20.0%	bbb+
Market position, size and diversification	12.5%	bb-
Portfolio assessment	12.5%	bbb-
Operating efficiency	5.0%	bbb
Business risk assessment	50.0%	bbb-
Ratio analysis		b
Risk appetite		b
Financial risk assessment	50.0%	b
Indicative credit assessment		bb
Liquidity		-
ESG		-
Peer comparison		-1
Standalone credit assessment		bb-
Support analysis		-
Issuer rating		BB-
Short-term rating		N-2

SEKm	2015	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT							
Revenue	94	116	135	208	339	370	379
Cost of goods sold	-21	-25	-32	-62	-102	-111	-114
Administrative costs	-14	-11	-18	-40	-34	-33	-34
EBITDA	61	81	88	113	204	226	231
Interest costs	-20	-20	-30	-77	-113	-129	-133
Interest on shareholder loans	-6	-6	-13	-5	0	0	0
Change in value of properties	50	15	120	666	68	0	0
Change in value of financial instruments				-3	-18	0	0
Pre-tax profit	83	65	163	712	156	113	113
Current tax	-1	-7	-4	-5	-11	-12	-13
Deferred tax	-20	-4	-36	-161	-16	0	0
Net Profit	62	53	123	547	128	101	100
BALANCE SHEET							
Investment properties	1,544	1,622	2,396	3,932	5,893	6,260	6,260
Other non-current assets	0	0	1	145	145	145	145
Total non-current assets	1,544	1,622	2,396	4,076	6,038	6,405	6,405
Cash and cash equivalents	20	37	360	77	166	39	71
Other current assets	13	14	35	112	112	112	112
Total current assets	33	51	395	189	278	151	183
Total assets	**1,577**	**1,673**	**2,791**	**4,266**	**6,316**	**6,555**	**6,588**
Total equity	318	363	776	1,372	2,050	2,151	2,250
Long-term interest-bearing loans	898	592	1,672	2,452	3,731	3,166	3,801
Shareholder loans			66		0	0	0
Other long-term liabilities	209	214	126	267	267	267	267
Total non-current liabilities	1,107	806	1,865	2,720	3,998	3,433	4,068
Total current liabilities	151	503	151	174	267	971	269
Total equity and liabilities	**1,577**	**1,673**	**2,791**	**4,266**	**6,316**	**6,555**	**6,588**
CASH FLOW STATEMENT							
Pre-tax profit	83	65	163	712	156	113	113
Cash flow before changes in working capital	37	47	21	24	145	101	100
Changes in working capital	25	9	-16	-29	0	0	0
Operating cash flow	62	56	5	-5	145	101	100
Cash flow from investment activities	-302	-111	-244	-1,298	-1,894	-367	0
Cash flow from financing activities	240	23	545	1,020	1,837	139	-67
Cash and cash equivalents beginning of the year	20	20	-12	294	11	100	-28
Cash flow for the year	**1**	**-32**	**306**	**-283**	**89**	**-127**	**33**
Cash and cash equivalents at the end of the year	20	-12	294	11	100	-28	5

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

Type of credit rating:	Long-term issuer credit rating Short-term issuer credit rating The rating is an initial credit rating.
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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.
Primary analyst: Secondary analyst:	Mille Opdahl Fjeldstad, mille.fjeldstad@nordiccreditrating.com, +47 990 389 16 Michael Andersson, michael.andersson@nordiccreditrating.com, +46 732 324 322
Rating committee chairperson responsible for approval of the credit rating:	Sean Cotten, sean.cotten@nordiccreditrating.com, +46 735 600 337
Methodology used when determining the credit rating:	Nordic Credit Rating - Corporate Methodology published 14 Aug. 2018: https://nordiccreditrating.com/pdf/Nordic%20Credit%20Rating%20-%20Corporate%20Rating%20Methodology.pdf Nordic Credit Rating - Rating Principles published 14 Aug 2018: https://nordiccreditrating.com/pdf/Nordic%20Credit%20Rating%20-%20Rating%20Principles.pdf The methodology and principles documents provide analytical guidance to NCR's rating activities including but not limited to, assumptions, parameters, and definitions. NCR's methodologies and principles can be found on our website: https://nordiccreditrating.com/governance/policies The historical default rates of entities and securities rated by NCR will be available on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml
Materials used when determining the credit rating:	Annual/quarterly reports of the rated entity Company presentations Bond prospectuses Meetings with management of the rated entity Website of rated entity Non-public information Press reports/public information Data provided by external data providers External market reports NCR considers the data it has analysed to be satisfactory and, to the best of its knowledge, believes the information to be reliable. However, NCR does not guarantee that the information used is fully adequate, accurate or complete.
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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: https://nordiccreditrating.com.
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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NORDIC CREDIT RATING AS

OSLO
Biskop Gunnerus' gate 14A
0185 Oslo
Norway
www.nordiccreditrating.com
post@nordiccreditrating.com

STOCKHOLM
Engelbrektsgatan 9-11
114 32 Stockholm
Sweden