

Community service properties - sheltered from the storm?

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This comment does not reflect a rating action on any of the mentioned issuers.

Nordic Credit Rating (NCR) believes that community service property management companies will maintain credit worthiness in the coming year due to the nature of the properties and their contracts. Community service tenants are typically government or municipality-funded and on long-term contracts in customised properties with low vacancy. However, the current situation and the development of this crisis is expected to increase transparency with respect to which properties are truly low-risk, government funded community service properties, and which are not.

NCR has reviewed the tenants of [Vacse AB \(publ\)](#) (Vacse), [Fastighets AB Stenvalvet](#) (Stenvalvet) and [Offentliga Hus i Norden AB](#) (Offentliga Hus), and expect nearly all contracts to continue to yield rental income throughout a volatile and uncertain 2020.

DRAMATIC CHANGES FOR COMMERCIAL REAL ESTATE COMPANIES

The exponential spread of the corona virus and the risk of unknown levels of community transmission has resulted in European countries responding by closing their borders and shuttering schools, universities and sporting events. Social distancing across Europe and movement restrictions has led to uncertain futures for Nordic companies like SAS and Scandic which have been forced to lay-off thousands of employees. NCR expects the closure of factories, offices and other workplaces will continue for an undetermined period despite government support measures.

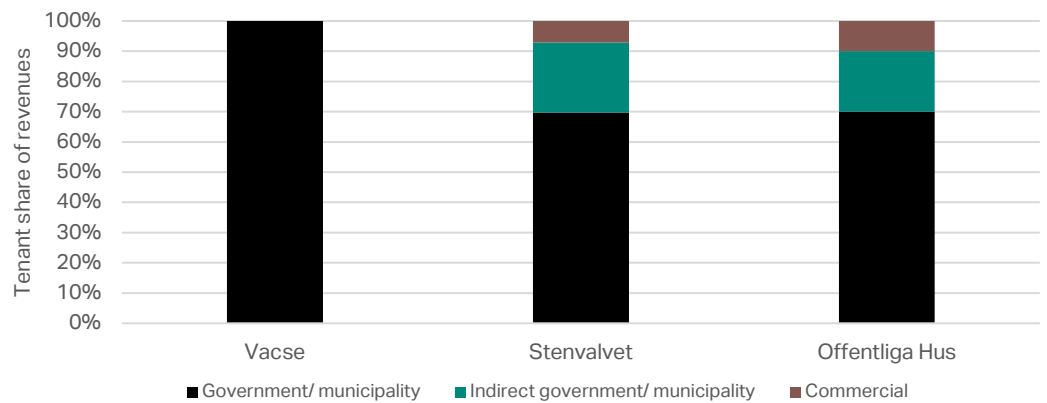
With such a sudden drop in revenues for their tenants, commercial real estate companies are likely to have lower rental income through temporary deferral or permanent adjustments to rental terms and face difficult negotiations for future contracts. In addition, the tightening of capital markets will reduce the number of real estate transactions, further pressuring companies to revise downward existing property valuations, affecting access to additional capital. The corresponding decline in valuations and revenues will affect key credit metrics such as loan-to-value (LTV), interest coverage ratio (ICR) and most importantly – liquidity. Following coordinated financial support from regulators and central banks, we believe that Nordic banks have the ability to finance business lending, but banks are likely to be conservative with existing valuations and security demands. See [Coordinated relief package supports bank creditworthiness](#), 16 March 2020.

COMMUNITY SERVICE PROPERTIES SHOULD WEATHER THE STORM

In our view, community service properties are equipped to manage a market downturn given the continued or increasing need for government services during a crisis. We expect the governments to make emergency increases in spending on health care and social support for unemployment during the coming year. In addition, the services of the police, courts and municipalities are vital during periods of economic stress. This ensures that revenues from community service properties will be more reliable and supportive of existing valuations and interest coverage than for commercial properties. However, we expect community service properties to show weakness where there are weaker links to government revenues and risks more reflective of commercial tenants.

Below are short comments on each of the community service companies rated by NCR.

Figure 1. Share of publicly-financed revenue, as of 31 Dec 2019



Source: Company reports

NORDIC CREDIT RATING – COMMUNITY SERVICE PROPERTY MANAGEMENT

NCR has three public ratings on community service property companies, and do not at this point adjust any of the three ratings or outlook.

ISSUER	LAST RATING ACTION	LONG-TERM RATING	OUTLOOK	SHORT-TERM RATING
Vacse	28/10/2019	BBB+	Positive	N-1+
Stenvalvet	05/02/2020	BBB+	Stable	N-1+
Offentliga Hus	29/11/2019	BB-	Stable	N-2

VACSE

Our 'BBB+' rating on Vacse reflects the company's strong portfolio of modern, tailor-made properties leased on long contracts (averaging around 10.1 years) to public-sector authorities that are essential to Sweden's public security. As of 31 Dec. 2019, Vacse has a property portfolio of SEK 6.5bn of which 100% of revenues stem from government (84%) or municipalities (16%), with the majority from community-critical services such as police, prisons and courts. We do not expect the company's rental revenues to be affected by Sweden's corona virus response.

Vacse is mainly funded through equity, bonds and secured bank debt, with equity to total assets of close to 50%. Vacse recently received funding of SEK 400m through the Nordic Investment Bank (Jan 2020) and utilised most of the funds to repay a revolving credit facility (RCF) of SEK 350m. Following the repayment of the RCF, the company has SEK 620m in available liquidity from SEK 120m in cash and equivalents and SEK 500m in available RCF. We note that the company has commitments through acquisitions of two new buildings coming into the portfolio in early 2021. Vacse's next maturing obligation is in April 2021 and given our expectation of government and municipalities honouring their lease contracts and material available liquidity, we do not believe Vacse to have financial constraints in the short-term.

STENVALVET

Our 'BBB+' long-term issuer rating on Stenvalvet reflects the company's strong property portfolio. The properties are mainly used by the community service sector. Nearly all of the company's rental income comes directly or indirectly from government financing (69% from public-sector tenants and a further 23% from private-sector health care operators receiving government funds).

The remaining 7% of revenues stem from commercial tenants within parking, retail and office space. We see some risk of potential rent renegotiations, but with a manageable impact on revenues.

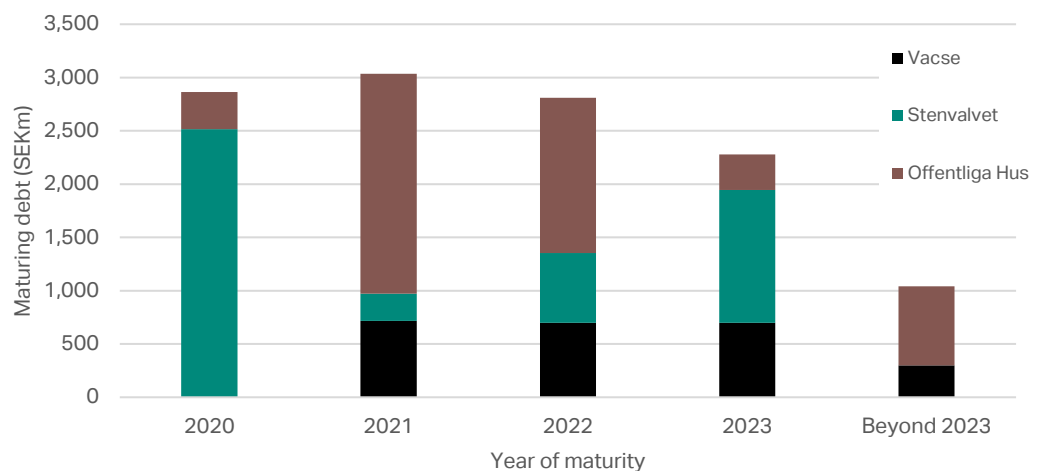
Stenvalvet is mainly funded through bank debt, bonds, shareholder loans (which we view as equity) and equity, with equity to total assets of 47%. Following its SEK 750m bond emission in January 2020 and an increase in credit lines in the beginning of March 2020, the company is expected to have sufficient cash or back-up facilities for the SEK 1.3bn in commercial paper maturing during 2020 should the certificate market be inaccessible. The remaining maturities for 2020 consist of an additional SEK 1.5bn in bank financing spread over a significant amount of loans. We expect Stenvalvet to be able to refinance with one or more of its four major banks, albeit at higher interest rate levels.

OFFENTLIGA HUS

Our 'BB-' long-term rating on Sweden-based public service property provider Offentliga Hus reflects the company's strong property portfolio and long-term contracts, averaging over five years. Offentliga Hus' tenants include government bodies and municipalities (90% of the company's rental income comes from public-sector tenants and private-sector tenants typically within the health care segment and indirectly funded by the government). We view the remaining 10% of rentals revenues to be more at risk of renegotiation or temporary deferral. We note that the contracts on 9% of the property portfolio mature during 2020, and should the company be unsuccessful in renegotiate new contracts or forced to adjust rental terms, this could apply further pressure to revenues.

Offentliga Hus is mainly funded through bank debt, equity and bonds with equity to total assets of 34%. As of 31 Dec. 2019, the company held SEK 116m in cash holdings, and has agreed to SEK 78m in acquisitions payable during first half 2020. The company has SEK 700m in bonds maturing June 2021, and short-term debt of SEK 145m as of 31 Dec. 2019. The company has recently diversified its bank relationships, which we view as important in the current environment. Given the current level of risk aversion in the market, we will continue to monitor the company's access to capital markets and liquidity as its obligations come due.

Figure 2. Debt maturity, as of Mar. 2020



Source: Stamdata and company reports

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