Fastighets AB Stenvalvet (publ)

Rating Update

LONG-TERM RATING

BBB+

OUTLOOK

Stable

SHORT-TERM RATING

N-1+

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RATING RATIONALE

Our 'BBB+' long-term issuer rating on property management company Fastighets AB Stenvalvet (Stenvalvet) reflects the company's strong property portfolio. The properties are mainly used by the community service sector with 92% of the rental income generated financed directly or indirectly by government funding (68% of the rental income comes from public-sector tenants and a further 24% comes typically from private-sector health and care operators in receipt of government funding). The portfolio consists of 105 diverse properties throughout Sweden, with an average remaining lease term of more than six years, an occupancy rate of about 96%, and stable rental and service revenues. The rating also reflects Stenvalvet's solid financial position with a loan-to-value (LTV) ratio of 42%, including external debt, and an interest coverage ratio of 5.9x over the last 12 months, as of 31 Mar. 2020 by NCR's measures. The company's shareholders have provided SEK 2.8bn in shareholder loans, which we consider equity, and constitute a long-term and stable ownership group.

These strengths are somewhat offset by Stenvalvet's relatively short-term financing needs, with 40% of all external debt maturing over the next 12 months. However, the company has increased its cash balance in response to COVID-19 and has available facilities of about SEK 1.7bn to match these needs. About 8% of tenants are purely commercial, mainly operating alongside government-related anchor tenants. Some 23% of the company's properties are used as government and municipal offices, while a large majority of properties are tailor made, such as facilities for the elderly, schools and health care.

STABLE OUTLOOK

The stable outlook reflects our expectation that Stenvalvet will continue to focus on community service properties, with long lease contracts under which rents are funded directly or indirectly by public institutions. We expect Stenvalvet to continue to refinance its short-term debt proactively to reduce the proportion of short-term debt in its overall debt mix. We also expect that the company will retain its moderate leverage (including LTV below 50%) and risk appetite as it grows via development and acquisitions.

POTENTIAL POSITIVE RATING DRIVERS

- Long-term LTV levels below 40% and stable earnings metrics.
- Increased diversification and quality of the property portfolio.

POTENTIAL NEGATIVE RATING DRIVERS

- Increased leverage, with long-term LTV above 50%.
- Higher share of non-community service tenants.
- Inability to refinance debt maturities.

Figure 1. Stenvalvet key credit metrics, 2017-2022e

SEKm	2017	2018	2019	2020e	2021e	2022e
Revenue	735	811	857	821	878	951
Adjusted EBITDA	503	542	586	538	580	632
Investment properties	9,941	11,105	12,025	13,247	14,082	14,862
Adjusted net debt	4,770	5,121	5,071	6,183	6,866	7,462
Total assets	10,321	11,535	12,486	13,275	14,079	14,903
NCR-adjusted debt/EBITDA (x)	9.5	9.5	8.7	11.5	11.8	11.8
NCR-adjusted EBITDA/interest (x)	6.2	5.7	5.5	5.6	6.5	6.1
NCR-adjusted LTV (%)	48.0	46.1	42.2	46.7	48.8	50.2

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

COMPANY PROFILE

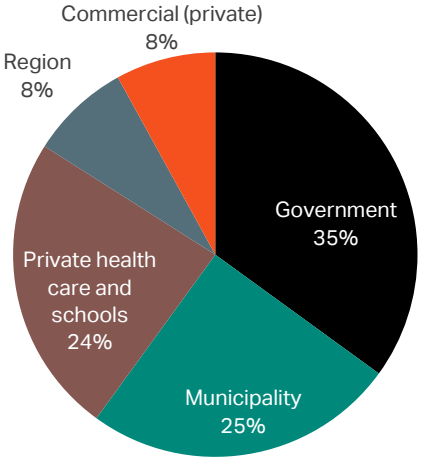
Stenvalvet was founded in 2010 when AI Pension, Alecta Pension foundation, and the Church of Sweden's pension foundation joined together with the purpose of purchasing, developing and managing homes for the elderly in the Mälardalen region. Following the acquisition of Roxanne Real Estate Foundation AB in 2014, the ownership structure was broadened to include Kåpan Pensions and the Swedish Foundation for Strategic Research. During 2019, the ownership consolidated when AI and Alecta sold their positions on a pro rata basis to the other three owners. In addition, in May 2020 the company changed its CEO for the first time in its history. As of 20 Apr. 2020, the company's property portfolio consisted of 105 properties with a leasable area of 571,000 square meters.

OPERATING ENVIRONMENT

Operating environment scores 'a-'

Stenvalvet's property portfolio mainly consists of community services properties with rental income paid directly or indirectly by the Swedish government or local municipalities. The company's focus is on homes for the elderly, health care institutions, schools, police stations, court houses, and other government and municipal agencies with tenants that are important for Sweden's welfare system. Given the government's association with many tenants, rental income is expected to remain stable with low correlation with the economic cycle or the ongoing economic effects of the COVID-19 pandemic.

Figure 2. Stenvalvet rental income by tenant type, 31 Mar. 2020

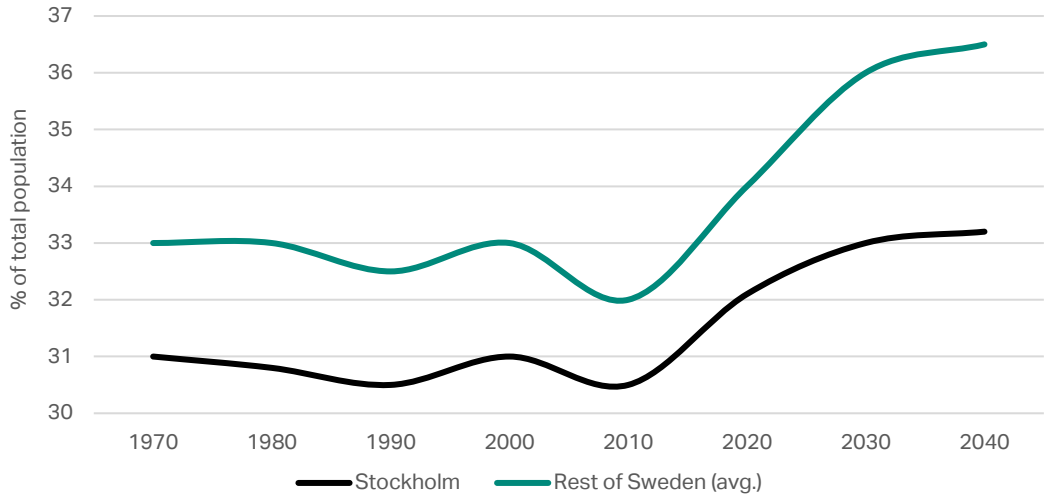


Source: company data

Stenvalvet has a focus on residential care for the elderly and people with disabilities, which strengthens the company's credit profile. According to the company's business strategy, at least 20% of the rental revenue should come from this segment and about 50 of the company's properties are health and care units with relatively high specialisation needs and long rental contracts. Schools are another focus area for Stenvalvet. This is a growing segment given that the Swedish government and municipalities expect a shortage of about 1,500 schools nationally over the next decade as the population grows and new areas are developed. We believe that projected demographic changes in Sweden will lead to further increases in demand for these types of properties, especially in the youngest and oldest age groups. In our view, Swedish political parties are committed to providing for public security and health and care services. We also note that most Swedish municipalities face financial constraints and are looking to sell community-service properties to reduce growing debt burdens.

Stenvalvet maintains its diversity by stipulating that a maximum 25% of the portfolio's market value can be held in any one municipality, and a maximum 10% of its market value can reside in a single property.

Figure 3. Recent and projected trends in Swedish population below 20 and above 75



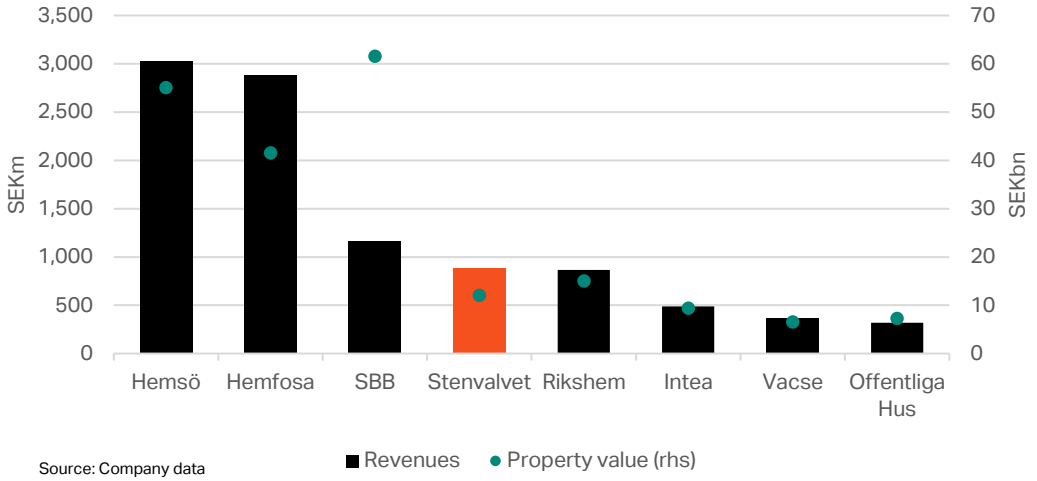
Based on data from the Swedish central bank, Stenvalvet, and NCR

MARKET POSITION, SIZE AND DIVERSIFICATION

Market position, size and diversification assessed as 'bb+'

Stenvalvet's property portfolio is worth around SEK 12bn and generates annual revenues of nearly SEK 900m, which makes the company a mid-sized community-service property manager in Sweden. The largest peers in the segment, Hemsö, Hemfosa, and Samhällsbyggnadsbolaget (SBB) are considerably more diversified than Stenvalvet, though with somewhat weaker financial risk profiles. Smaller peers such as Vacse and Intea have more concentrated portfolios, but a higher share of specialised properties, providing strong risk-adjusted returns with direct government revenues on long-term contracts. In addition, the growth opportunities and relatively low risk of the community-service market have increased the competition from diversified real estate managers such as Castellum, Vasakronan, Klövern, and Balder, which have strategic positions in less specialised community-service property markets alongside more traditional commercial real estate assets.

Figure 4. Swedish community-service property managers by revenues and property value, 2019

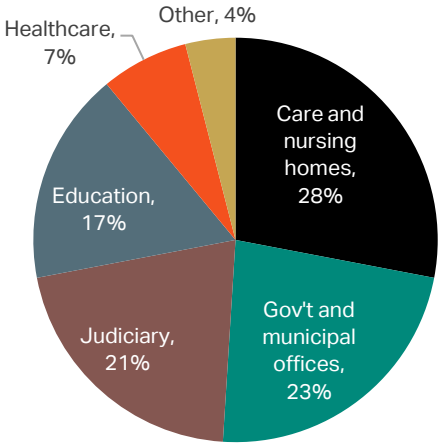


Source: Company data

During 2019, Stenvalvet made nearly SEK 3bn in transactions in order to focus its portfolio on growth regions and more clearly defined community properties. In total, the company sold SEK 1.1bn in assets in mostly smaller municipalities and purchased SEK 2.2bn in primarily elderly care assets in Örebro and Stockholm, as well as other focus areas such as Eskilstuna, Växjö, and Jönköping. The transformation increased the company's geographic profile somewhat, but also simplified the business

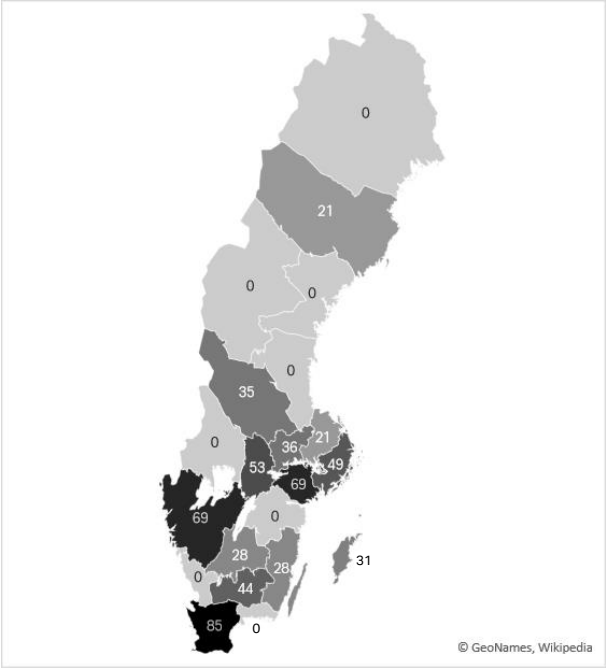
by removing a region from its coverage and narrowing its focus. As of May 2020, the company's largest markets by rental income were in the mid-size communities of Växjö, Örebro, Eskilstuna, Uppsala and Jönköping in Sweden's central and southeast regions rather than the country's largest cities. In our view, the company remains well positioned and relatively diversified within Sweden's demographic growth areas.

Figure 5. Stenvalvet properties by type, 31 Dec. 2019



Source: company data

Figure 6. Stenvalvet leasable sqm (000s) by region, Apr. 2020



We note that Stenvalvet has some concentration among its largest tenants (see Figure 7), but note that each of the largest tenants has direct or indirect tax-payer financing. In our view, the relative concentration of private care companies, which are financed by local municipalities, is the main concentration risk. However, we believe that the corresponding risk in private care companies is offset by the social responsibility of the respective municipality to provide housing and care for its elderly and special needs citizens. We also note that the average length of rental contracts for specialised care and school facilities is the longest in Stenvalvet's portfolio.

Figure 7. Stenvalvet's 10 largest tenants, 31 Mar. 2020

Tenant	Share of rental income
Swedish police	12%
International English Schools in Sweden	8%
Örebro municipality	6%
Swedish court administration	6%
Attendo Sverige AB	4%
Region Skåne	4%
Umeå municipality	3%
Swedish Tax Agency	3%
Swedish prison and probation service	3%
Uppsala municipality	2%
Total	**52%**

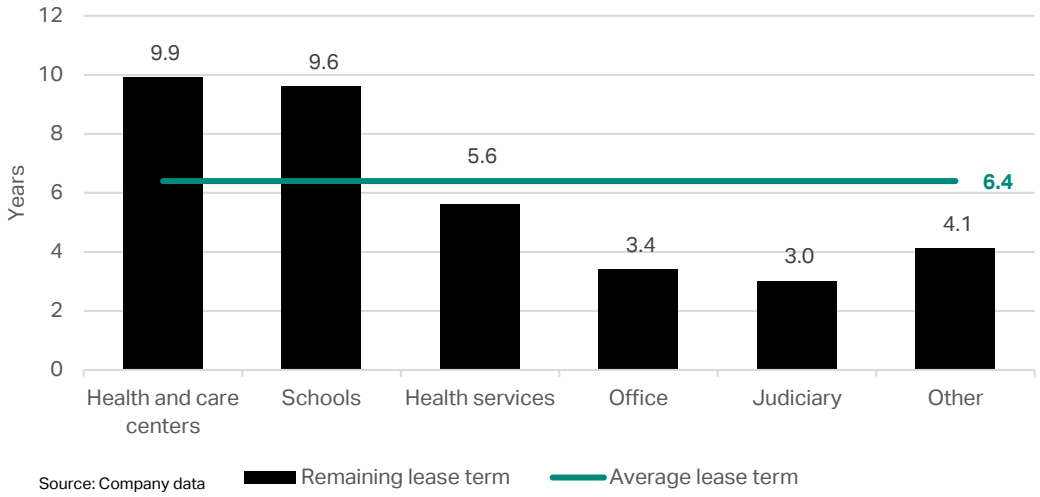
PORTFOLIO ASSESSMENT

Portfolio assessment is 'bbb+'

As of 20 Apr. 2020, Stenvalvet's property portfolio consisted of 105 properties totalling 571,000 leasable square metres with an average remaining lease term of 6.4 years. Although rental contracts vary in length, they are typically renegotiated and index linked. We view the company's portfolio assets as relatively strong given the societal role of many of its properties as well as the importance of stability and specialised properties for schools and care facilities, law enforcement, and the judicial system.

At 31 Mar. 2020, the company reported that only 4% of rental contracts would mature in the remainder of the year. The figure for 2021 increases to 14% of rental income, though we note that as of May 2020 over 85% of maturing leases through 2021 are directly associated with local or national government bodies, law enforcement agencies, the judiciary, and municipality agency tenants, which often remain in the same buildings for decades.

Figure 8. Stenvalvet average lease term by segment, 31 Mar. 2020



Stenvalvet has increased its focus on projects and currently has eight projects under development. The share of development properties remains relatively low within the total portfolio and rental revenues easily generate enough cash for capital expenditures. Typically, development and refurbishment projects are carried out at the request of providers of care for the elderly and local authorities and entail long contracts that limit risk.

We expect Stenvalvet to pursue its strategic target of SEK 1bn growth per year and to invest an average of SEK 500m per year in new acquisitions to achieve these goals. So far in 2020, the company is ahead of schedule and has announced the acquisition of four properties – an office in Växjö, a school in Stockholm (Vällingby), a care facility in Hässleholm, and an elderly care facility in Ronneby. We believe that the company is using its financial position and access to financing to acquire assets at attractive prices resulting from distressed capital markets.

Figure 9. Stenvalvet's active projects, as of May 2020

Property	Property type	Project status	Estimated completion	Investment (SEKm)*
Drabanten, Upplands Väsby	Elderly care	Development	2020	
Vägbrytaren 1 (K43), Eskilstuna	Offices	Development	2021	325
Sicklaön 118:2, Nacka	School	Development	2021	365
Valören 1, Eskilstuna	Courts	Development	2021	145
Vintrosa (phase 2), Örebro	Elderly care	Development	2021	
Rosstorp 2, Salem	Elderly care	Development	2021	
Vedbo 59, Västerås	School	Development	2021	
Kabelrullen 3, Älvsjö	School	Development	2021	

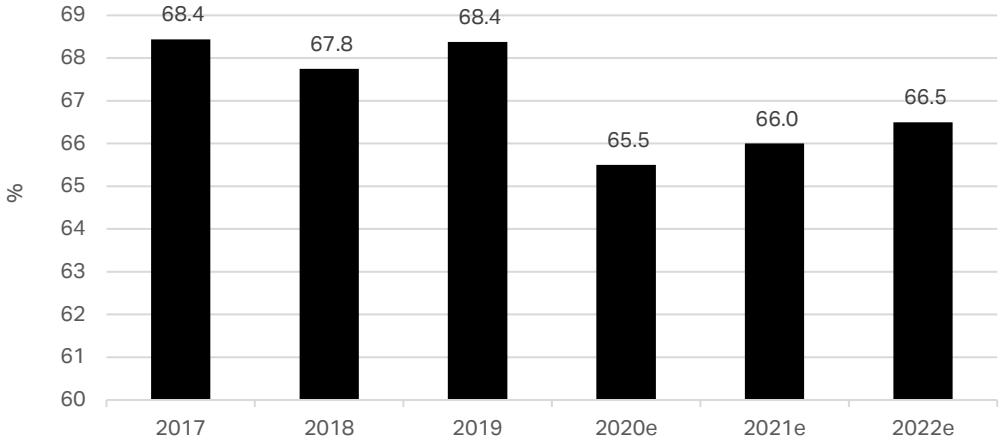
Source: company data. *Based on 2019 annual report, only published figures shown.

OPERATING EFFICIENCY

Operating efficiency scores 'a'

Stenvalvet's operational performance has been strong in recent years. This is mainly due to the nature of the company's contracts and tenants, as well as an increased focus on retaining long-term tenants and improving cost efficiency. We project Stenvalvet's EBITDA will fall somewhat given the sale of SEK 1.1bn in income-generating properties in 2019 and increased investments in development properties. However, we forecast EBITDA margins will remain above 65% and eventually return to historical levels closer to 67% as larger projects reach completion. A modest increase in vacancy rate is expected after the COVID-19 pandemic but is likely to be limited to a small portion of non-community-associated rental guests and unlikely to affect our view of the company. We note that a large majority of maturing leases are with government related entities and as such are expected to be extended without material downward adjustments to rental agreements as a result of the pandemic's impact on working environments.

Figure 10. Stenvalvet adjusted EBITDA margin, 2017-2022e



Source: Company data

FINANICIAL RISK PROFILE

Financial risk profile scores 'bbb+'

Our financial risk assessment of Stenvalvet reflects our projections of adjusted LTV rising from 42% at the end of 2019 towards 49% by 2022 assuming no value adjustments aside from capital expenditure and acquisitions. Given the sale of income-generating property in 2019 and the current investments in development projects, we anticipate EBITDA will decline, but remain well above 5x interest costs over the next three years. Our assessment also takes into account Stenvalvet's relatively prudent risk appetite and long-term ownership commitments, including shareholder loans.

While we note that there is some potential for a reduction in the valuation of the company's portfolio following the COVID-19 pandemic, we view the majority of the real estate portfolio as resistant to material valuation shifts given the expectation of high occupancy rates and stable revenues.

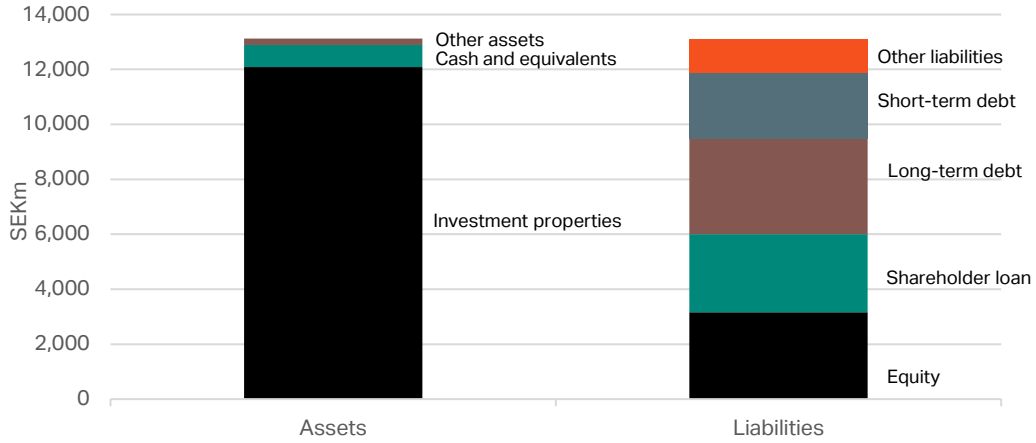
As of 31 Mar. 2020, Stenvalvet's main source of funding was secured bank debt, which comprised 65% of the company's outstanding debt. Of the company's SEK 5.9bn of external interest-bearing debt, some SEK 1.3bn is commercial paper. The secured bank debt is relatively evenly spread between four large Nordic financial institutions (SEB, Nordea, Handelsbanken, and Nykredit) and the company has internal limits on single lenders to ensure diversified funding. Since January 2020, Stenvalvet has had a medium-term note program of SEK 5bn for issuing in Swedish kronor and euro. The company issued its first bond, a four-year senior unsecured bond, for SEK 750m in February 2020. We anticipate no further senior unsecured debt financing in the near term given the current gap between capital market and bank financing rates due to the disruption in the capital markets because of COVID-19. However, we believe that Stenvalvet will increase its use of unsecured financing when markets return to normal and pricing improves.

In addition to providing equity, Stenvalvet's shareholders fund the company through a SEK 2.8bn shareholder loan with a 9% annual interest rate. We classify this loan as equity and consequently exclude it from our credit metric calculations. This is because:

- we view Stenvalvet's owners as strategic long-term owners;
- the loan matures well beyond all other debt;
- it is subordinated to all other debt; and
- interest payments can be deferred.

The shareholders have committed a further SEK 495m in funds which we consider in our liquidity analysis. In addition, the company can convert the shareholder loan to equity, if necessary.

Figure 11. Stenvalvet balance sheet, 31 Mar. 2020



Source: Company data

In our base case, we assume the following:

- rental income to fall by 4.2% in 2020 due to the sale of income-generating property and development investments in 2019, with growth resuming in 2021 and 2022 at about 2% per annum;
- adjusted EBITDA margin to remain at 65-70%;
- interest cost on external debt averaging about 100m per annum in 2020-2022;
- annual capital expenditure of SEK 420m per annum, due to investments in ongoing projects.
- additional debt-financed investments in properties of about SEK 550m per annum to achieve the target growth portfolio growth rate of SEK 1bn per annum; and
- no increase in the value of the existing portfolio, with the exception of capital investments in projects as they are finalised.

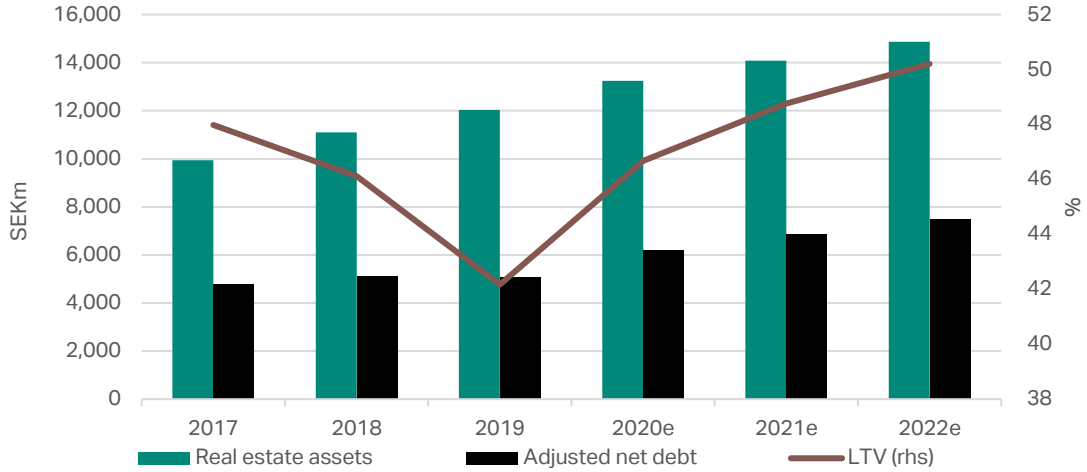
Based on these assumptions, we arrive at the following metrics for 2019–2021;

- LTV rising from 42% at end-2019 to 50% by 2022;
- Adjusted EBITDA to net interest to remain firmly over 5.5x; and
- adjusted net debt to EBITDA to increase towards 12x as the company uses additional debt to expand its portfolio.

As mentioned above, we exclude the SEK 2.8bn shareholder loan and SEK 250m of associated interest in our credit calculations. We note, however, the relatively high interest paid on the shareholder loan but expect the board to continue balancing shareholder returns against the company's growth ambitions and funding needs, and so retain credit metrics at current levels.

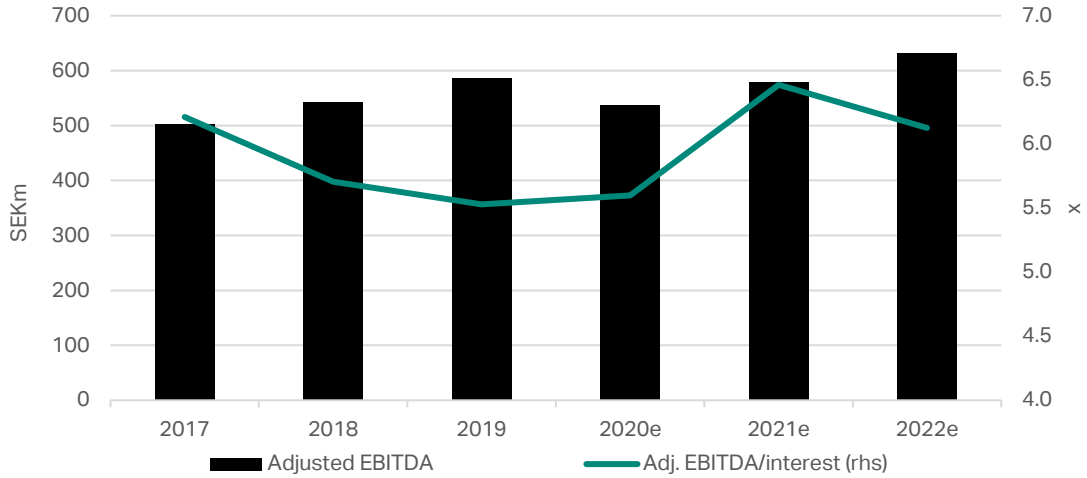
As shown below, we expect credit metrics to remain relatively stable over the next few years despite likely growth in the property portfolio. We also expect Stenvalvet to increase its share of unsecured debt as the portfolio and total gross debt increase, thus decreasing dependence on secured bank debt and shareholder loans.

Figure 12. Stenvalvet property values, adjusted net debt, and LTV, 2017-2022e



Source: Company data

Figure 13. Stenvalvet adjusted EBITDA and EBITDA/net interest, 2017-2022e



Source: Company data

RISK APPETITE

Risk appetite assessed as 'bbb'

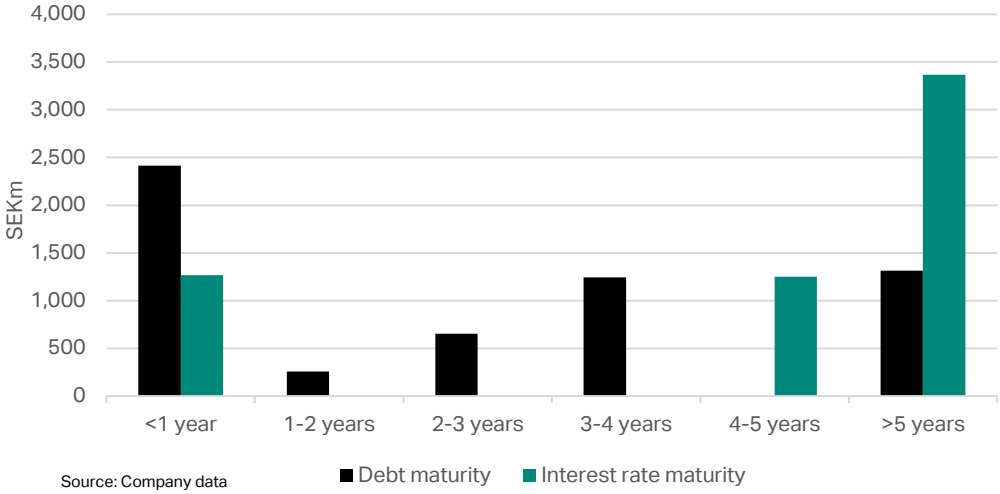
Stenvalvet has an ambitious, but controlled, growth strategy, in our view. We expect LTV to remain below 50%, given the company's recently revised limit of 55% under its financial policy. We view the company's decision to focus on specific markets as prudent given the size of the organisation and the increased synergy in managing properties in select mid-sized growth markets. We expect Stenvalvet to remain active in acquiring new income-generating assets that fit with its corporate strategy and view the company's internal limits for revenues by municipality and property as a strong management tool to avoid portfolio concentrations. In our view, the company's financial targets, debt maturity profile, and growth ambitions are commensurate with our risk appetite assessment.

LIQUIDITY

Liquidity is a neutral factor due to strong bank relationships

We assess Stenvalvet's liquidity profile as adequate despite the relatively large amount of short-term debt. The average debt maturity is just over three years, however, some 41% of total external debt is to be refinanced within the 12 months ending in March 2021. We expect Stenvalvet to be able to roll over its bank loans as it maintains a strong relationship with four Nordic banks and note that the company managed to issue nearly SEK 1bn in commercial paper in April and May of 2020, despite the turbulence in the capital markets. We expect any shortfalls to be covered by existing credit facilities, cash on balance sheet and operating cash flow, with additional committed shareholder loans available as a last resort.

Figure 14. Stenvalvet debt maturity profile, 31 Mar. 2020



Source: Company data

We estimate the following primary liquidity sources of SEK 3.1bn for the 12 months through 31 Mar. 2021:

- cash and equivalents of SEK 607m, adjusted for 25% stress;
- available credit facilities of SEK 1.7bn;
- expected funds from operations of SEK 283m, adjusted for 25% stress; and
- a committed shareholder injection of SEK 495m.

We anticipate liquidity uses of SEK 3.5bn over the 12 months through 31 Mar. 2021:

- SEK 1.3bn of maturing certificates;
- SEK 1.2bn of secured debt maturities;
- about SEK 600m in committed acquisitions made in April and May 2020; and
- planned capital expenditure and investments totalling SEK 475m, assuming committed projects are completed on schedule.

We note that the shortage in liquidity is driven by the company's recently announced acquisitions, for which we expect the company has secured some external financing. Stenvalvet has had access to the certificate market since the end of March 2020, issuing SEK 990m between 14 Apr. and 19 May 2020 with maturities of 2-3 months, compared with SEK 100m which matured on 28 May 2020 which also contributes to our view that liquidity remains a neutral rating factor. We anticipate that the company will issue additional bonds from its SEK 5bn program when the market for senior unsecured bonds stabilises.

ESG ASSESSMENT

ESG assessment is neutral

Stenvalvet's environmental, social and corporate (ESG) governance policies support our view of the company's overall business risk and competitive position. In early 2019, Stenvalvet solidified its commitment to ESG issues by hiring a full-time sustainability and innovation manager to increase the integration of ESG into all facets of the business and defined seven of the UN Sustainability Goals as relevant for the company.

Stenvalvet's environmental commitment is focused on reducing energy and water consumption at its buildings. The company has a focus on sustainable material selection in production and refurbishment of its buildings and aims to reduce its properties' energy consumption by 20% as well as reduce water consumption by 10% by 2023. Stenvalvet has not committed to any third-party environmental certifications for its properties, but monitors the energy consumption of its buildings remotely to identify issues in the portfolio. The company is also implementing green rental agreements with its clients to encourage them to consider water and energy efficiency when using its facilities. The company holds its contractors, subcontractors and vendors accountable for fulfilling its requirements for sustainability. Finally, the company has communicated plans to implement a green lending framework in the next few quarters.

Stenvalvet takes social responsibility for its community-service facilities and clients. One focus area is providing a comfortable and inspiring indoor environment at its elderly care facilities. The company strives for gender equality and has a broad mix of men and women in leadership roles as well as competence development for all of its employees.

Despite some new members of the management team, the reduction in the number of owners solidifies the long-term strategy of the company and its commitment to sustainability given the owners' own sustainable investment mandates. Stenvalvet has a well-defined and prudent risk appetite and a limit system to avoid concentration risk and maintain financial targets. It also seeks to ensure that key information is reported to management at least monthly.

SUPPORT, OWNERSHIP AND CREDIT ENHANCEMENT

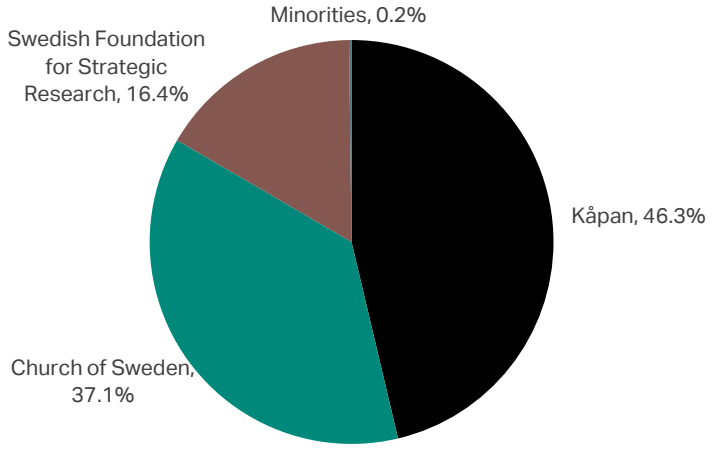
Ownership support is neutral

We view Stenvalvet's ownership structure as supportive of the rating as we believe the owners have a long-term focus on their investments. Stenvalvet's main owners are:

- Kåpan Pensions, which manages collectively agreed pensions for Swedish government employees;
- The Church of Sweden's pension foundation; and
- The Swedish Foundation for Strategic Research

The owners are financially strong, with over SEK 100bn under management, and have a long-term focus on their investment. All three owners have a clearly stated sustainability focus in their investment guidelines. Accordingly, we believe that there is sufficient economic strength to support Stenvalvet, if needed. We also believe that the owners will balance growth, investment and shareholder returns in a way that does not weaken Stenvalvet's creditworthiness.

Figure 15. Stenvalvet ownership structure



Source: company data

ISSUE RATINGS

Stenvalvet is financed primarily by secured bank loans and senior unsecured obligations. The share of secured bank loans is more than 50% of outstanding debt (65% at 31 Mar. 2020) and for this reason NCR notches long-term senior unsecured obligations down by one notch in line with our criteria.

Figure 16. Stenvalvet key financial data

SEKm	2017	2018	2019	Q12020 LTM
INCOME STATEMENT				
Revenue	735	800	857	897
Cost of goods sold	-212	-232	-259	-246
Selling, general & admin. expenses	-27	-37	-43	-46
EBITDA	503	542	586	605
Interest costs	-81	-95	-106	-102
Interest on shareholder loans	-204	-226	-254	-256
Change in value of properties	394	319	475	560
Pre-tax profit	610	626	744	766
Net Profit	**472**	**585**	**559**	**594**
BALANCE SHEET				
Property portfolio	9,941	11,105	12,025	12,085
Total non-current assets	9,957	11,168	12,043	12,215
Cash and cash equivalents	335	315	349	809
Total current assets	364	367	453	911
Total assets	**10,321**	**11,535**	**12,496**	**13,126**
Total equity	1,982	2,566	3,125	3,158
Long-term interest-bearing loans	4,471	4,122	2,708	3,469
Shareholder loans	2,400	2,548	2,848	2,848
Other long-term liabilities	492	605	736	844
Total non-current liabilities	7,363	7,275	6,292	7,161
Total current liabilities	976	1,694	3,079	2,807
Total equity and liabilities	**10,321**	**11,535**	**12,496**	**13,126**
CASH FLOW STATEMENT				
Pre-tax profit	610	626	744	766
Operating cash flow	277	349	243	335
Cash flow from investing activities	-1,021	-849	-448	352
Cash flow from financing activities	952	480	239	-115
Cash and cash equivalents at the beginning of the year	127	335	315	428
Cash flow for the year	**208**	**-20**	**34**	**572**
Cash and cash equivalents at the end of the year	335	315	349	809

Figure 17. Scoring summary sheet

Subfactors	Impact	Score
Operating environment	20.0%	a-
Market position, size and diversification	12.5%	bb+
Portfolio assessment	12.5%	bbb+
Operating efficiency	5.0%	a
Business risk assessment	50.0%	bbb+
Ratio analysis		bbb+
Risk appetite		bbb
Financial risk assessment	50.0%	bbb+
Indicative credit assessment		**bbb+**
Liquidity		Adequate
ESG		Adequate
Peer comparisons		Neutral
Stand-alone credit assessment		**bbb+**
Support analysis		Neutral
Issuer rating		**BBB+**
Outlook		Stable
Short-term rating		**N-1+**

Figure 18: Capital structure ratings

Seniority	Rating
Senior unsecured	BBB

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 14 May. 2019.
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:	Sean Cotten, +46735600337, sean.cotten@nordiccreditrating.com
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Were ESG factors a key driver behind the change to the credit rating or rating outlook?	No.
Methodology used when determining the credit rating:	NCR's Corporate Methodology published on 14 Aug. 2018 NCR's Rating Principles published on 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).
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