

Swedish property sector feels the chill of cement dispute

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An unresolved legal dispute over a lime-mining permit for Sweden's biggest cement producer has become a source of uncertainty for the country's construction and real estate sectors. It could also derail efforts by individual property companies to meet environmental targets on CO₂ emissions. Cementa AB, which generates three-quarters of Sweden's cement output at a site at Slite in Gotland county, has said it might not be able to meet demand from the domestic construction industry without an extended mining permit, and that cement exports could also suffer. The dispute has taken on a political dimension, with the Swedish parliament overriding environmental and judicial objections to extend the current operating licence. Here, we examine the possible impact on the domestic real estate sector in terms of access to materials and green financing, as well as meeting environmental targets.

In July this year, Cementa's Slite facility, which supplies most of the cement used in Sweden, failed to obtain approval for a renewed 20-year operating permit, related to the mining of lime used in cement production. The company's previous permit was originally scheduled to expire at end-October, causing widespread concern about the country's cement supply. The Supreme Land and Environmental Court rejected the renewal application on environmental grounds, saying Cementa had failed to show sufficient proof that it was not contaminating ground water in the Slite locality. In response to fears that supply constraints might halt construction activity and increase unemployment, the government initially decided to grant Cementa a permit to use already-mined lime, pushing the permit deadline until mid-2022. It subsequently created legislation enabling Cementa to continue operations until end-2022, effectively overriding the court's decision.

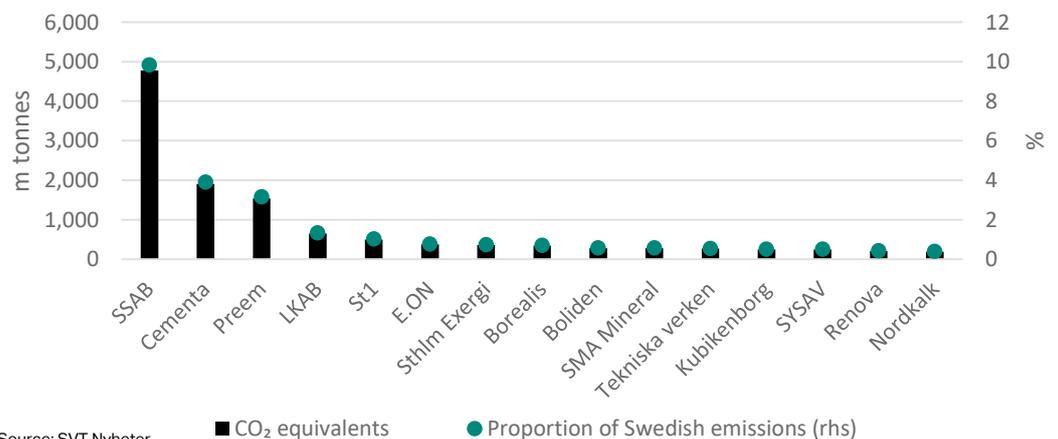
The Cementa dispute affects a wide range of property and construction companies, not only in terms of access to materials, but also in their transition to carbon neutrality through reduction of Scope 3 (indirect) emissions. In addition, we look at social and governance factors and the negative impact of uncertainty on both economic and sustainability parameters. We also discuss the dispute's implications for the Swedish real estate sector.

In our opinion, the Cementa dispute does not currently warrant any rating revisions. However, we are monitoring events closely, should the situation drastically change.

ENVIRONMENTAL FACTORS AT THE HEART OF THE DISPUTE

This Cementa dispute is centred on environmental factors, an area where the company has a major impact. Cementa was Sweden's second-largest emitter of CO₂ equivalents in 2020. This implies that success in fully achieving the company's stated goal of net-zero emissions by 2030 at the Slite production site would have a material impact on emissions at a national level.

Figure 1. Sweden's top 15 emitters of CO₂ equivalents, 2020



Source: SVT Nyheter.

■ CO₂ equivalents

● Proportion of Swedish emissions (rhs)

In our view, a long-term operating permit is necessary if the owner, Germany-based HeidelbergCement, is to commit to the level of investment required to meet the subsidiary's long-term environmental targets and to ensure that the investment is economically viable. A long-term permit would, in our opinion, be welcomed not only in the construction and real estate sectors, but also by investors, and environmental stakeholders. However, we also take the view that reduction of greenhouse gas emissions cannot be allowed to occur at the expense of access to clean water.

Much is unclear in the current legal limbo, in particular what feasible alternatives will be available by end-2022 in terms of cement supply to end-users. If domestic property companies are forced to use imported cement, particularly from distant locations, the sustainability mandates under which they operate and obtain financing could be jeopardised. Cementa can reapply for a long-term mining permit, covering a timeframe that would allow investments in net-zero cement production. However, the company has said that just over a year is insufficient to prepare an application for the 20-year permit it deems necessary to achieve this target. In addition, it is not yet clear how the Supreme Administrative Court will rule on legal objections to the government's recent legislation that effectively allows Cementa to continue mining lime on Gotland, creating the possibility that that permission to operate could be withdrawn.

SOCIAL AND LEGAL ISSUES ALSO IN PLAY

The dispute raises several social concerns. For example, uncertainty about the future supply of concrete could jeopardise ongoing efforts to reduce Sweden's domestic housing deficit. Currently, the National Board of Housing, Building and Planning (Boverket) estimates the deficit at 180,000 units, and says the country needs to build 60,000 units a year through 2029. Although the target construction rate appears achievable, a significant and lasting shortage of cement could prove a major setback, in our view.

A key aspect of the dispute is legal opposition to the government's effective granting of Cementa's temporary permit to mine lime. The legislation created to enable the permit has drawn sharp criticism from the Council on Legislation (Lagrådet), which has deemed it unconstitutional. The possibility that the temporary permit could be legally overturned could affect Cementa's ability to operate, while creating governance issues for companies operating under Swedish environmental legislation. If the permit is not overturned, the legal precedent could increase moral hazard issues, should companies, including Cementa, come to expect preferential treatment because their operations are deemed vital to the economy.

Figure 2. Key ESG factors affecting or affected by the Cementa dispute

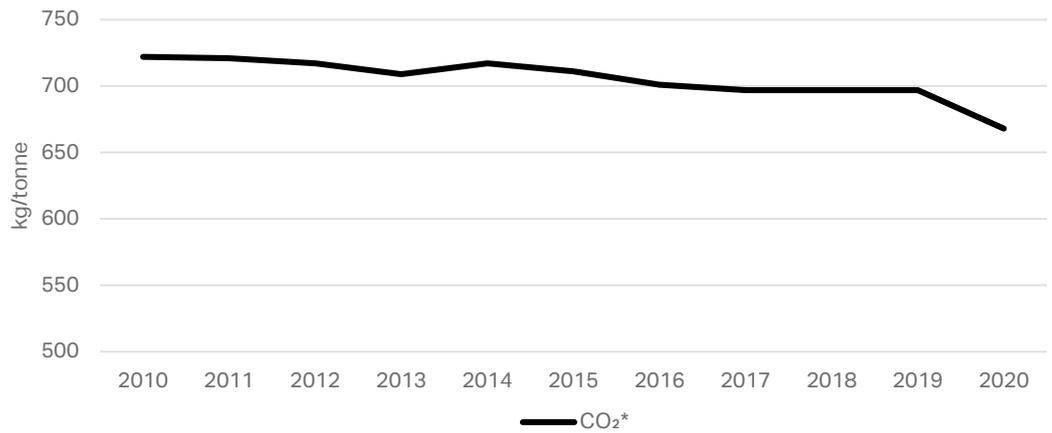
| Environment | Social | Governance |
|---------------------------|-------------------|--|
| CO ₂ emissions | Access to housing | Moral hazard arising from state intervention |
| Access to clean water | Noise impact | |

IMPLICATIONS FOR THE REAL ESTATE SECTOR

We closely follow the Swedish real estate sector as part of our remit to monitor the companies we rate. In this respect, we pay particular attention to environmental, social and governance (ESG) risk, which features heavily in our corporate analyses (see [Nordic property managers face green crossroads](#), published 16 Mar. 2021, and [ESG factors in corporate ratings](#), published 31 Mar. 2020).

Sweden uses about 3bn tonnes of cement each year, with about 75% coming from Cementa's Slite facility. The remainder comes from another Cementa production site at Skövde on the Swedish mainland or is met by imports. Neither source could readily fill the gap if the Slite facility were to face closure. Nordkalk AB, a Swedish subsidiary of Finland-based lime producer Nordkalk, has an operation located on Gotland and could provide an alternative to Cementa's own lime production. However, to date, Nordkalk AB has been unable to meet Cementa's criteria for quality, while the quantities it can supply are limited by transport restrictions imposed by noise regulations.

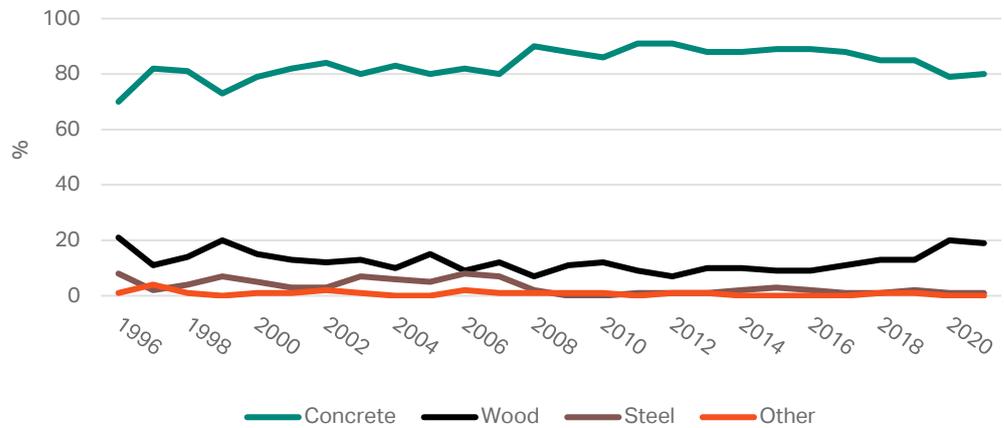
Figure 3. CEMENTA CO₂ emissions, 2010-2020



Source: CEMENTA. *Slite and Skövde production sites combined.

The current impasse is not the first occasion on which the Swedish real estate sector has faced shortages of materials, real or potential. We do not currently consider the risk of a long-term standstill of construction and renovation activity as particularly severe. We also note that the Swedish real estate management companies rated by NCR are less exposed to CEMENTA than they would be if they were primarily operating in construction. Given the importance of cement to the real estate and construction industries, we believe that a resolution will be found within a reasonable timeframe that enables affected property managers to deal with delays in construction and renovation work. Nonetheless, we remain acutely aware of the uncertainty the dispute is causing, and will continue to monitor events as they unfold.

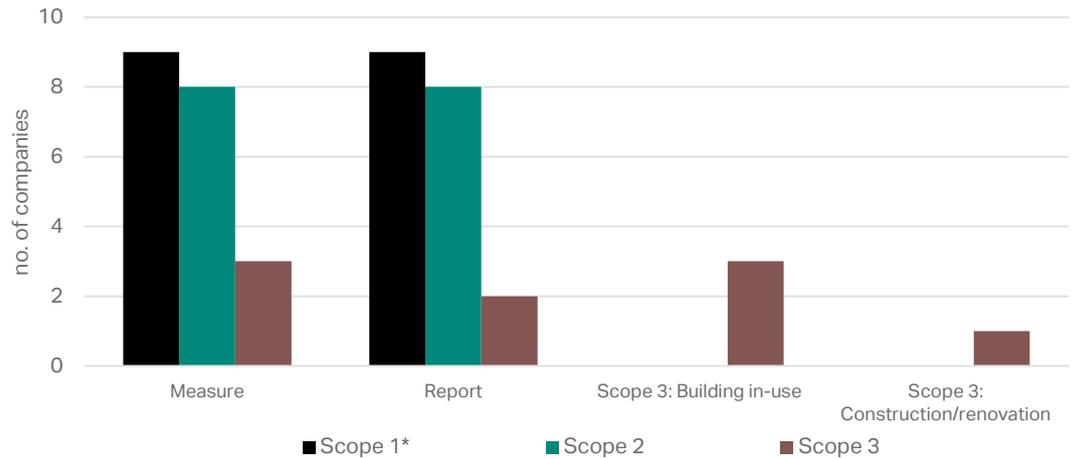
Figure 4. Material used in foundations of new apartment buildings in Sweden, 1996-2020



Source: Statistics Sweden.

As of end-September 2021, 37% (SEK101bn) of the SEK 270bn in Swedish real estate corporate bonds outstanding were classified as green. In our rating assessments, we view access to green financing as a positive rating factor. We take a cautious view of companies that face difficulty accessing green finance due to poor sustainability efforts or failure to report sustainability issues. While no standardised definition currently exists for the classification of green bonds, investors and other stakeholders are increasingly seeking information not only about direct factors such as energy, water usage and transport options, but also the indirect impact of activities such as construction and renovation, which generate Scope 3 emissions.

Figure 5. NCR rated Swedish real estate companies' greenhouse gas reporting, 2020



Source: company reports. Out of 12 published issuer ratings. Scope 1-3 refers to greenhouse gas emissions, where Scope 1 is the most direct emissions, and Scope 2 & 3 are indirect emissions.
 *includes companies which report CO₂ emissions without defining scope.

Strong sustainability performance can give real estate companies better access to financing. In our assessment of a company's real estate portfolio, we generally view green building standards as a credit strength as they increase the attractiveness of a property to current and future tenants. This is particularly valid in the case of commercial real estate. Most NCR-rated issuers seek to boost their green credentials through certification of existing buildings. Such certification generally focuses on energy and water usage, and transport availability. However, many of these issuers have exposure to the environmental impact of the production of construction materials, either through renovation or new production. These activities can be outsourced but are ultimately associated with the property manager and counted as Scope 3 emissions.

In view of increasing attention to environmental issues, the outcome of the Cementa dispute will clearly be important to Swedish real estate companies' sustainability efforts and investors' sustainability mandates. In particular, the difference between use of imported cement with a negative environmental footprint against domestic production with net-zero emissions will be significant in terms of both green finance and property attractiveness.

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