Nordic Credit Rating

CORPORATE: REAL ESTATE

Sweden
14 Mar. 2023

Heba Fastighets AB (publ)

Rating Action Report

LONG-TERM RATING

BBB

OUTLOOK

Negative

SHORT-TERM RATING

N3

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Heba Fastighets AB long-term issuer rating lowered to 'BBB'; Outlook negative

Nordic Credit Rating (NCR) said today that it had lowered its long-term issuer rating on Sweden-based Heba Fastighets AB (publ) to 'BBB' from 'BBB+'. The outlook is negative. The 'N3' short-term rating was affirmed. At the same time NCR lowered the senior unsecured issue rating to 'BBB' from 'BBB+'.

Rating rationale

The rating action on the long-term issuer rating reflects a decline in Heba's financial metrics due to rising interest rates and lower property values. Heba's interest coverage ratio fell throughout 2022 and was 3.2x for the full year 2022 (from 4.6x in 2021), compared with our expectation of approximately 3x in September 2022. Furthermore, the NCR-adjusted net loan-to-value (LTV) ratio rose significantly to 47.8% at year-end 2022, compared with our previous projection of 43.7%.

Without measures to support the financial profile, we expect credit metrics to decline further. We project the company's average interest rates will continue to rise, pushing interest coverage ratios, excluding one-off items, below 2x in 2024 and 2025. In 2023 and 2025, however, Heba's debt servicing ability is likely to be supported by one-off payments from joint ventures. Due to the regulated rental market, Heba has limited ability to raise rents in line with interest and other cost increases. Earnings are, however, supported by the 20% of rental revenue stemming from inflation-linked contracts, higher-than-usual rent increases for residential properties, and by hedged electricity costs. We also project that LTV will rise as residential property values decline amid increasing yields. This will put further pressure on the long-term rating if the company is unable to remain in line with its financial policy target of maintaining LTV below 50%.

Heba has drastically reduced its project exposure and proposed a reduced 2022 dividend to support its credit metrics. In addition, the company has continued to hedge interest rates on a large portion of its interest-bearing debt. We expect the company to make further efforts to maintain its financial policy targets. As projects are finalised and new developments put on pause, we expect both project risk and joint venture exposure to remain low in the coming years. We expect Heba's business risk profile to remain strong, and the rating continues to reflect the company's long and stable history of managing residential rental properties in Stockholm, Sweden's highest-demand housing market. It also reflects Heba's low refinancing risk, due to its extensive credit facilities and the company's historically moderate financial risk appetite.

Tight capital markets and higher interest rates have led Heba to replace unsecured financing with a higher share of secured bank financing. If the company's unsecured debt as a proportion of total debt remains below 50% over a protracted period (43% at year-end 2022), it could affect our view of recovery prospects for senior unsecured bondholders and, consequently, our issue ratings.

Negative outlook

The negative outlook reflects our expectation that, barring any significant action taken by the company, metrics will likely weaken in line with our forecast. Pay-outs from joint ventures support our forecast, and we believe there is further potential for the company to take measures to outperform our base case. Nonetheless, the risk of further interest rate hikes in Sweden remains, and we expect property values to decline as yield requirements increase, adding pressure on the company's ability to maintain metrics within its financial policy. However, we remain uncertain as to the extent and timing of changes in property values.

We could lower the rating to reflect an NCR-adjusted interest coverage ratio below 2.2x or NCR-adjusted net LTV above 55% for an extended period. We could also lower the rating to reflect an increasing refinancing risk as a result of worse financing conditions, or in the event of significant issues with joint-venture partners, affecting Heba's one-off payments and financial commitments.

We could revise the outlook to stable if the NCR-adjusted interest coverage ratio remains above 2.2x, excluding one-off payments, and NCR-adjusted net LTV remains below 50% for an extended period. We could also the revise the outlook to stable to reflect action taken by the company to support its financial risk profile.

Rating list	**To**	**From**
Long-term issuer credit rating:	BBB	BBB+
Outlook:	Negative	Negative
Short-term issuer credit rating:	N3	N3
Senior unsecured issue rating:	BBB	BBB+

Figure 1. Heba rating scorecard

Subfactors	Impact	To	From
Operating environment	20.0%	a	a
Market position, size and diversification	12.5%	bb	bb
Portfolio assessment	12.5%	bbb+	bbb+
Operating efficiency	5.0%	a	a
Business risk assessment	50.0%	bbb+	bbb+
Ratio analysis		bb+	bbb+
Risk appetite		bbb-	bbb+
Financial risk assessment	50.0%	bb+	bbb+
Indicative credit assessment		**bbb**	**bbb+**
Liquidity		Adequate	Adequate
ESG		Adequate	Adequate
Peer comparisons		Neutral	Neutral
Stand-alone credit assessment		**bbb**	**bbb+**
Support analysis		Neutral	Neutral
Issuer rating		**BBB**	**BBB+**
Outlook		Negative	Negative
Short-term rating		**N3**	**N3**

Figure 2. Capital structure ratings

Seniority	To	From
Senior unsecured	BBB	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 28 May. 2020.
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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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 Rating Methodology published on 18 Feb. 2022 NCR's Rating Principles published on 24 May 2022 NCR's Group and Government Support Rating Methodology published on 18 Feb. 2022 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.
Potential 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. NCR does not have any direct or indirect shareholder with a holding of more than 5% of NCR's shares and votes. For further information, please refer to NCR's conflict of interest policy which is available on: https://nordiccreditrating.com/governance/policies
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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