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Research Update:

Swedish Housing Group Framtiden 'AA-/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

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Table Of Contents

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Overview

- We believe Framtiden's financial performance will improve over its 2017 results following its planned revenue and expense efficiency measures, despite increased maintenance costs.
- At the same time, Framtiden's debt will likely increase due to the group's upcoming capital expenditure program.
- We are affirming our 'AA-/A-1+' and 'K-1' ratings on Framtiden.
- The stable outlook reflects our expectation that, despite rising debt, Framtiden's financial management will stick to its financial policy and maintain its financial performance.

Rating Action

On Oct. 23, 2018, S&P Global Ratings affirmed its 'AA-/A-1+' long- and short-term issuer credit ratings on Swedish public housing provider Förvaltnings AB Framtiden. The outlook is stable.

At the same time, we affirmed our 'K-1' short-term Nordic regional scale rating on Framtiden.

Rationale

We expect Framtiden's capital expenditures (capex) will reach high levels in 2018-2020, owing to the strong demand for housing in the City of Göteborg (AA+/Stable/A-1+), leading to a heavier debt burden. At the same time, we believe that Framtiden will strengthen its financial performance, with S&P Global Ratings-adjusted EBITDA at 26.7% of revenues in 2020 from 25.7% in 2017 after adjustment for capitalized repairs.

We rate Framtiden one notch above its stand-alone credit profile (SACP), which we assess at 'a+', since we see a high likelihood of the company receiving extraordinary support from its owner, Göteborg.

Framtiden has a very strong enterprise profile, stemming from low industry risk, very good asset quality, and strong strategy and management. We continue to view Framtiden's financial profile as strong, largely because of risk-averse financial policymaking and a moderate, albeit increasing debt burden. Relatively modest debt-service coverage, despite increasing reliance on loans from the city treasury, and average financial performance constrain the SACP.

In our view, the high likelihood of extraordinary support from Göteborg stems from Framtiden's:

- Important role for Göteborg, which regards the group as an important contributor to the city's overall infrastructure and public policy, as illustrated by the city's ambitious goals for new construction. The group had 72,500 housing units in the Göteborg area at end-2017 and is the largest social housing provider in the city; and
- Very strong link with the city, which is actively involved in defining Framtiden's strategy, appoints its board of directors, and intends to maintain its 100% ownership.

We consider that the low industry risk for social housing providers in Sweden, due to low cyclicality of revenues and close oversight from the city, benefits Framtiden. Also, the company enjoys robust demand for its rental apartments as Göteborg expands, which results in minimal vacancies. We calculate the average price of private homes in Göteborg at a high 187% of the national average. This, combined with very strong population growth of 1.4% annually over the past three years, creates excellent economic fundamentals.

On Oct. 5, 2018, Mr. Terje Johansson was appointed Framtiden's new CEO. He was previously the CEO of MKB Fastighets AB and has strong expertise and experience in the public housing sector. We do not expect any significant changes to Framtiden's current strategic planning process nor risk management under the new management.

Framtiden's properties are generally well maintained, with maintenance expenditures amounting to about Swedish krona (SEK) 1.1 billion (about €0.1 billion) in 2017. Although Framtiden's less strict, rental policy may marginally increase rent arrears, we do not believe that this would hurt the company's creditworthiness. The rental policy, which took effect in 2017, removed the income requirement and included the acceptance of payment defaults.

We continue to view Framtiden's financial profile as strong. We expect its financial performance will improve, but remain average compared with that of international peers. In order to strengthen its self-financing capacity given upcoming investment needs, Framtiden recently launched an efficiency program to contain the growth of expenses related to maintenance, repairs, and existing stock of properties. We expect Framtiden's EBITDA margin will improve gradually over 2018-2020 compared with 2017, with the five-year (2016-2020) average at 26% after the adjustment for capitalized repairs.

We believe that Framtiden's debt to EBITDA is set to increase over the forecast horizon as a result of the capex program that the company will undertake over the coming years.

The demand for housing in Göteborg has been strong for many years, which led the city council to increase its new-construction target to 1,400 housing units per year from 2018. We expect Framtiden will invest an average of SEK3.4 billion annually in 2018-2020 in new construction, adding SEK2.4 billion of net new loans per year. We project that the company's ratio of debt to EBITDA will reach 13.8x by end-2020 from 10.6x in 2017. At the same time, Framtiden has a strong loan-to-value ratio of 19% and headroom within its interest coverage ratios. Although Framtiden has significant unencumbered assets, we do not observe a willingness or any contingency plan to sell such assets so that the debt score would change. Moreover, we currently see less risk that debt repayments will affect the debt service coverage than before.

As of Aug. 31, 2018, Framtiden's loans totaled SEK16.8 billion (SEK15.9 billion the year before), of which SEK16.3 billion (SEK13.2 billion previous year) came from the city treasury, and SEK0.5 billion (SEK2.7 billion the year before) consisted of senior unsecured medium-term notes in its own name.

Liquidity

We continue to regard Framtiden's liquidity as adequate, with a liquidity sources-to-uses ratio currently at 123%, up from 120% in 2017. Framtiden has now been almost fully integrated into the city's treasury, and has transferred almost all external refinancing risk to the city treasury except for a SEK0.5 billion medium-term note that matures in November 2018. We consider the transfer of risk as ongoing financial support from the owner and therefore include a cash injection equivalent to Framtiden's estimated capex for the coming 12 months alongside maturing debt and interests, totaling SEK10 billion.

The majority of Framtiden's outstanding debt of SEK16.8 billion comes from the city treasury. We estimate that about SEK6 billion in loans will mature within the next 12 months and we incorporate them, alongside SEK3.5 billion of planned capex over the next 12 months, in our estimate of liquidity uses. However, since Göteborg has assumed financing responsibility for Framtiden, we include equivalent funds in our estimate of liquidity sources.

Framtiden no longer has ready access to the capital markets. However, its access to financing via the city treasury is a mitigant. In addition, Framtiden holds a meaningful amount of unpledged assets that it can use to obtain funding from banks.

Framtiden's financial relationship with the city is formalized in legal documents stating that the city will be responsible for supplying funding to the company. We expect this formalization to remain intact since the city has an interest in securing funding for the new construction it has mandated the group to produce.

Outlook

The stable outlook reflects our expectation that, despite a rising debt burden and a potential marginal increase in arrears, Framtiden's financial management will stick to its financial policy and strengthen the company's financial performance over the next two years. We do not foresee any changes in Framtiden's ownership and support structure that would affect our view of the group's role for or link with Göteborg.

We could raise the ratings if Framtiden's relationship with the city strengthened further, for example through a formal, unconditional, and irrevocable guarantee or stronger contractual ties with the city treasury. We could also raise the ratings if we saw a marked improvement in Framtiden's financial risk profile, with better performance and a stronger liquidity position.

We could lower the ratings if there is greater pressure on Framtiden's financial risk profile. This could, for example, occur if we observed a marked deterioration in financial performance, together with debt accumulation beyond our current projections.

Table 1

Forvaltnings AB Framtiden Key Statistics

	--Year ends December 31--				
(Mil. SEK)	**2016a**	**2017a**	**2018e**	**2019bc**	**2020bc**
Number of units owned or managed	72,388	72,466	N.A.	N.A.	N.A.
Vacancy rates (% of rent net of identifiable service charge)	1.0	1.0	N.A.	N.A.	N.A.
Revenue	5,763.3	5,877.0	6,016.8	6,169.8	6,326.5
EBITDA*	1,439.4	1,510.2	1,567.1	1,631.4	1,688.6
EBITDA/revenue (%)	25.0	25.7	26.0	26.4	26.7
Interest expense	372.1	301.4	325.4	362.0	417.6
Debt/EBITDA (x)	11.0	10.6	11.1	12.4	13.8
EBITDA/interest coverage (x)	3.9	5.0	4.8	4.5	4.0
Capital expense	1,561.3	1,667.9	2,437.0	3,747.0	4,016.0
Debt	15,843.0	16,015.5	17,444.3	20,246.0	23,286.7
Housing properties (according to balance sheet valuation)	27,692.8	28,566.1	30,162.6	33,038.3	36,073.4
Loan to value of properties (%)	57.2	56.1	57.8	61.3	64.6
Cash and liquid assets	2.5	4.3	0.0	0.0	0.0

*Adjusted for capitalized repairs. SEK--Swedish krona. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Forvaltnings AB Framtiden Ratings Score Snapshot

Table 2

Industry Risk	2
Economic fundamentals and market dependencies	1

Forvaltnings AB Framtiden Ratings Score Snapshot (cont.)

Table 2

Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	4
Debt profile	2
Liquidity	4
Financial policies	2
Financial profile	3

S&P Global Ratings bases its ratings on the main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Global Ratings Definitions, June 26, 2017

Ratings List

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Ratings Affirmed

Forvaltnings AB Framtiden
 Issuer Credit Rating                    AA-/Stable/A-1+
 Nordic Regional Scale                   --/--/K-1
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