

Research Update:

# Forvaltnings AB Framtiden Outlook Revised To Negative; 'AA-/A-1+' And 'K-1' Ratings Affirmed

October 26, 2023

## Overview

- We forecast that Förvaltnings AB Framtiden (Framtiden) will experience continued pressure on its S&P Global Ratings-adjusted EBITDA margins as rent settlements are not fully compensating the effects of inflation.
- We anticipate new developments will remain subdued in the near term, as building costs and interest rates limit their profitability.
- We therefore revised the outlook to negative from stable and affirmed our 'AA-/A-1+' long- and short-term issuer credit ratings on Framtiden.
- The negative outlook reflects the risk that Framtiden's financial metrics could structurally weaken due to a limited ability to compensate inflation with rental increases, which could pressure its adjusted EBITDA margin and interest coverage.

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## Rating Action

On Oct. 26, 2023, S&P Global Ratings revised the outlook on the 'AA-' long-term issuer credit rating on Forvaltnings AB Framtiden to negative from stable. At the same time, we affirmed the 'AA-/A-1+' long- and short-term issuer credit ratings and our 'K-1' Nordic regional scale rating on Framtiden.

## Outlook

The negative outlook reflects the risk that Framtiden's financial metrics could structurally weaken due to a limited ability to compensate inflation with rental increases, which could pressure its adjusted EBITDA margin and interest coverage.

## Downside scenario

We could lower the rating if management failed to contain the effects of high cost inflation on its

EBITDA margin. Structurally lower EBITDA margins might also impair debt metrics and lead us to lower the rating.

## **Upside scenario**

We could revise the outlook back to stable if rents grow more than our expectations, or if management manages to make structural improvements, for instance by cutting expenditure to support EBITDA margin strengthening. We could also revise the outlook back to stable if our assessment of likelihood of support from its owner improved.

## **Rationale**

The outlook revision reflects our view that Framtiden's expenditures are pressured by high inflation and that coming rent settlements could structurally shift margins to levels below 20% unless management implement structural improvements to compensate for lower rent increases.

## **Enterprise profile: Framtiden's size and the demand for rental housing in Göteborg underpin its strong market fundamentals**

Framtiden benefits from providing housing in Sweden's second largest city, Göteborg, with a focus on core traditional housing activities that have very strong demand. Framtiden also benefits from being the largest public housing provider in Sweden with over 75,000 units. As a result, the risk of vacancies in Framtiden's portfolio is very low, and limited to turnover from moving tenants or renovations.

We consider Framtiden's management to have prudent financial planning and risk management, given they consistently monitor and stress test operations under various scenarios. Framtiden has strict control of its cash flows, with the flexibility to adjust any capital projects if needed. Furthermore, Framtiden has a track record of adhering to its internal targets, set by the owner, including keeping loan-to-value and equity ratios at satisfactory levels.

We also consider that Framtiden has scaled down new housing developments at its subsidiary Göteborgs Egnahems AB over the coming years as current market conditions are weaker. The subsidiary has been developing condominiums for sale as an additional revenue source, but we expect Framtiden will keep this segment below 7% of total revenue as a result of the lower development pace in the coming years. Although these activities are socially motivated, considering they improve the mix of housing in the city districts, they are more exposed to market risk, in our view.

We assess the regulatory framework for Swedish public housing companies as very strong, (see "Regulatory Framework Assessment: Swedish Public Housing Providers' Rent-Setting Scheme Balances Income And Costs," published May 22, 2023, on RatingsDirect).

## **Financial profile: Margins under pressure from limited rent increases**

As inflation has remained higher for longer, Framtiden's margins are contracting. In 2022, our adjusted EBITDA margins fell to 17.8%, but we think this level that will not fall further in 2023 due to a combination of the 4.25% rent increases agreed upon and efficiency gains on expenditure. For 2024, we expect rents to grow by 6%, which will help margins recover somewhat. We will monitor how Framtiden responds to rent increases in the coming years in order to return its EBITDA

margins to levels above 20%.

Through 2025, we expect capital expenditure (capex) to remain stable at about Swedish krona (SEK) 2.3 billion annually, out of which we view 25% as capitalized repairs that we adjust back as an operating cost. However, we expect Framtiden will focus less on developing new properties and more on investing in existing stock. This strategy reflects management's active decision to improve its quality of stock in socially challenged areas, i.e., areas with higher crime rates and typically higher maintenance needs. It also reflects a shortage of construction materials and lack of approved local plans. Framtiden aims to improve these areas and improve safety by enhancing the housing tenure mix (rental and condominium) and maintaining its properties. Current market conditions also limit condominium developments, which will decrease from SEK1.2 billion in 2021 to SEK200 million in 2023-2025.

As development is lower in 2023 and 2024, we expect debt to grow slower than in recent years. We estimate debt will grow by SEK1.3 billion to SEK25 billion by year-end 2025, resulting in debt to nonsales adjusted EBITDA of 16.5x. Lower developments in 2023-2024 will help Framtiden to contain debt, a positive given the fast-rising interest rates. Although Framtiden has a significant portion of fixed-rate liability, we expect higher interest rates will weaken the nonsales adjusted EBITDA interest coverage ratio to 2.7x in 2023 and weaken further in coming years as higher interest rates flow through the debt portfolio. In our view, if debt increases materially, it could negatively affect debt metrics.

We calculate Framtiden's liquidity sources will cover 1.12x of the coming 12 months' debt service. Its sources consist of cash and committed liquidity facilities totaling SEK600 million, our forecast operating cash flow of SEK1415 million, and working capital inflows and asset sales of SEK200 million. As part of our assessment of Framtiden's liquidity position, we consider the interaction between the company and city of Göteborg's in-house bank as ongoing financial support from the owner. Therefore, we include a cash injection equivalent to Framtiden's estimated capex for the coming 12 months alongside maturing debt and interests minus operating cash flow, totaling SEK5.3 billion. These sources cover uses of SEK6.7 billion that includes maturing debt, capex, and interest.

Even though Framtiden no longer taps capital markets on its own, we consider its access to external liquidity strong, because funding is managed by its owner's in-house bank, which we assess as having strong access to external funding.

## **Government-related entity analysis**

Framtiden is a fully owned subsidiary of the city of Göteborg (AA+/Stable/A-1+), via its holding company Göteborgs Stadshus AB. We believe Framtiden benefits from a high likelihood that its owner would provide timely and sufficient support in case of financial distress. Framtiden plays an important role as a key provider of housing for the city's growing population. Furthermore, we consider the link to Göteborg as very strong. The city is the sole owner and is actively involved in defining Framtiden's strategies.

## **Selected Indicators**

Table 1

## Förvaltnings AB Framtiden--Key statistics

Mil. SEK	--Year ended Dec. 31--				
	2021a	2022a	2023bc	2024bc	2025bc
Number of units owned or managed	75235	75767	76068.05	76329.8	77077.8
Adjusted operating revenue	7690.7	7384.4	7172.9	7539.2	7944.6
Adjusted EBITDA	1843.5	1317.0	1274.9	1462.0	1555.8
Nonsales adjusted EBITDA	1668.7	1289.9	1271.3	1459.4	1550.2
Capital expense	2481.6	2319.2	1542.2	1834.3	1867.8
Debt	22943.8	23690.7	24126.7	24926.7	25544.7
Interest expense	248.0	276.1	467.3	573.8	673.0
Adjusted EBITDA/Adjusted operating revenue	24.0%	17.8%	17.8%	19.4%	19.6%
Debt/Nonsales adjusted EBITDA (x)	13.7	18.4	19.0	17.1	16.5
Nonsales adjusted EBITDA/interest coverage(x)	6.7	4.7	2.7	2.5	2.3

a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

## Ratings Score Snapshot

Table 2

### Förvaltnings AB Framtiden--Ratings score snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	2
Market dependencies	2
Management and governance	2
Financial risk profile	2
Financial performance	4
Debt profile	3
Liquidity	3
Stand-alone credit profile	a+
Issuer credit rating	AA-

S&P Global Ratings bases its ratings on nonprofit social housing providers on the seven main rating factors listed in the table above. Our "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Ratings List

### Ratings Affirmed

#### Forvaltnings AB Framtiden

Issuer Credit Rating

Nordic Regional Scale --/--/K-1

### Ratings Affirmed; /Outlook Action

To

From

#### Forvaltnings AB Framtiden

Issuer Credit Rating AA-/Negative/A-1+ AA-/Stable/A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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