Real Estate Management & Development | Sweden

Heba Fastighets AB

Strong residential assets, low financial risk

- Significant housing shortage in Sweden should continue to drive demand
- Conservative leverage and strategy are supportive to the credit profile
- We initiate coverage with Market Perform

High demand for attractive rental apartments

Heba Fastighets AB (Heba) primarily owns and manages residential rental properties in the greater Stockholm area. Heba's properties are typically located in Stockholm's suburbs, with good transportation links and proximity to the city centre. We view Heba's property portfolio, which is continuously modernised and expanded, as strong. We believe the significant rental housing shortage in Sweden, and particularly in Stockholm, is unlikely to disappear in the foreseeable future, thereby buoying demand.

Modest leverage, controlled growth

Heba has a long track record of controlled, conservative growth while retaining moderate leverage. While we believe its loan-to-value (LTV) could increase slightly from the current 41%, we argue that Heba has one of the stronger balance sheets among Swedish real estate issuers. Heba's strong credit profile has been confirmed by a public rating of A- from Nordic Credit Rating (NCR).

Bond spreads appear fair

We initiate coverage on Heba with a Market Perform recommendation. We think Heba's limited size and track record in the Swedish bond markets is fairly reflected in slightly wider bonds spreads compared to similar rated, but significantly larger real estate peers Vasakronan (A3) and Rikshem (A3).

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Key figures

SEKm	2016	2017	2018	2019	2020
Op. net (NOIRE)	182	215	250	261	274
Income fr property mgmt adj	121	138	168	179	187
Net income adj	373	368	654	724	718
Property value	7,525	8,771	9,656	10,293	12,213
Gross debt adj	2,401	3,228	3,538	3,517	5,082
Net debt to prop value adj (%)	31.9	36.7	36.6	33.9	40.8
Total debt to total assets adj (%)	31.7	36.7	36.4	33.8	39.8
FFO/gross debt adj (%)	5	4	5	5	4
Gross debt/EBITDA adj (x)	14.7	17.1	15.9	15.0	21.0
EBITDA/interest expense adj (x)	3.8	3.7	4.1	4.3	4.3
Dividends/FFO adj (%)	50.4	45.5	45.5	53.5	53.0
Pledged assets to total assets (%)	33.0	38.9	34.8	29.0	33.0
Secured debt to total assets (%)	31.7	36.7	32.3	25.8	25.9

Source: Company reports and Handelsbanken Capital Markets

Main credit recommendation, SEK Senior unsecured

U Underperform | **M Market Perform** | O Outperform

Detailed recommendations

Senior unsecured	**SEK**		M

About the company

Profile:

Sweden-based Heba Fastighets AB was founded in 1952, listed in 1994. The company owns and manages residential rental apartments as well as community service properties in the greater Stockholm area. Total assets amounted to SEK 12bn as of December 31, 2020

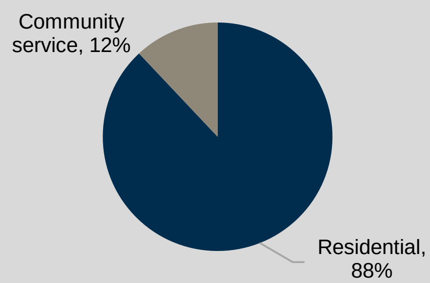
Data:

Web address: http:// www.hebafast.com
CEO: Patrik Emanuelsson
CFO: Frank Sadleir
Treasurer:

Public ratings:

	Long-term	Outlook
NCR	A-	Stable

Rental income distribution, 2020



Source: Company reports

Credit highlights

In our view, Heba's credit profile is supported by its strong property portfolio that primarily consists of attractive rental apartments in the greater Stockholm area, with a growing share of modern community service assets. In addition, we argue that Heba has one of the stronger balance sheets among Swedish real estate issuers, as well as a long track record of controlled growth and stable ownership. We acknowledge the company's small size and limited geographical diversification, but we find that these are relatively minor drawbacks compared with its strengths.

Key credit considerations

Supportive factors for Heba's credit profile – our view

We argue that Heba has an attractive property portfolio and a long track record of controlled growth and modest leverage

- An attractive residential real estate portfolio in the greater Stockholm area, where demand for residential housing remains high
- A growing share of modern community service assets, including elderly care properties, group housing, and day-care facilities
- A long and solid track record of controlled growth while retaining modest leverage
- A strong balance sheet, including a modest loan-to-value of 41%
- Good access to liquidity and capital through banks and through debt and equity markets
- A stable ownership structure, controlled by descendants of the company's founders
- Credible sustainability targets covering environmental, social and governance issues

Restrictive factors for Heba's credit profile – our view

We consider its small size and low diversification as restrictive factors

- The company is relatively small and has limited geographical diversification
- Exposure to changes in Swedish rental regulation legislation
- Rental income is to a large extent dependent on rental negotiations with tenant organisations
- Relatively high share of short-term debt, although we would expect this to be refinanced with longer-maturity debt ahead
- Increased share of development projects
- Swedish real estate peer SBB (rated BBB-) recently bought 21% of the share (representing 11% of the votes), which adds some uncertainty in regards to the ownership structure

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Company description

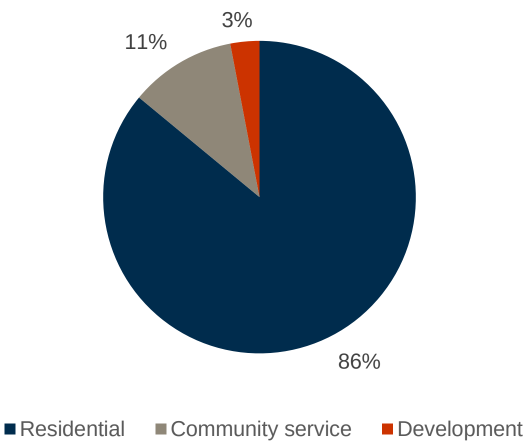
Heba Fastighets AB (Heba) is a listed Swedish real estate company that owns, manages and develops residential and community service properties, primarily in the greater Stockholm region. Its portfolio consists of 68 properties with a total of 3,372 apartments, as well as a growing share of community service facilities. As of December 31, 2020, the property portfolio is valued at about SEK 12bn. Descendants of the two founders (Karl Holmberg and Folke Ericsson) control the company through the majority of votes (A-shares).

Focus on Stockholm rental apartments

A well-known owner and manager of residential properties in Stockholm

Heba was founded in 1952 and listed in 1994. The company is primarily focused on residential rental properties, with a growing share of modern community service properties, in the greater Stockholm area. Heba owns and manages 68 properties, of which six are community service properties; in total, it holds 3,372 rental apartments and 361 community service facilities. While continuously expanding its residential portfolio through acquisitions and development, Heba also aims to grow its share of community service properties (elderly care, group homes, care facilities) to a maximum of 20% of its total property portfolio in the coming years. We believe the shortage of rental housing in Stockholm, as well as urbanisation and demographic trends, should ensure high demand for both asset classes.

Figure 1: Property value distribution by type (2020)



Source: Company reports

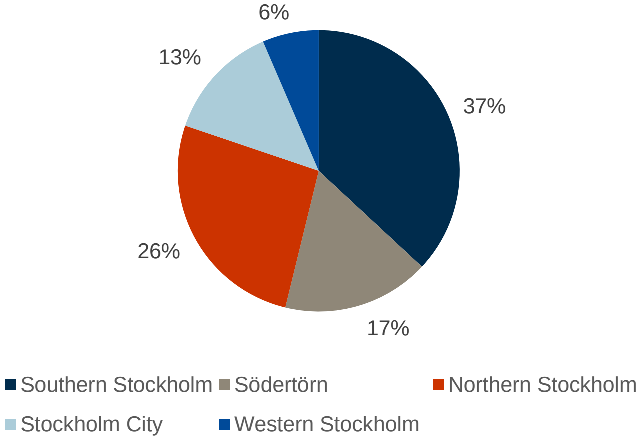
Heba continuously modernises and expands its portfolio

Heba's properties are located in relatively central suburbs with good access to public transportation. The majority of Heba's rental properties were built in the 1940s, 50s and 60s. Twenty-two percent of its rental properties were built in the last 10 years and 43% of its older assets have been refurbished to modern standards. Heba aims to expand, refurbish and modernise its portfolio in order to increase returns on the existing properties.

Heba also acquires and develops new properties, typically close to its current properties' locations. The Swedish rental regulation system makes it difficult for landlords to raise rents, thereby pressuring the return on investments in existing properties. However, for new-build apartments, production costs can be taken into account, allowing the landlord to demand a rent that is more similar to what an unregulated market would yield. As it is very difficult for landlords to differentiate rents independently of the location of the apartments, many rental apartments have historically been transformed into tenant-owned co-operative apartments. In addition, construction of new rental housing has been low for many decades, leading to a significant shortage of affordable rental apartments.

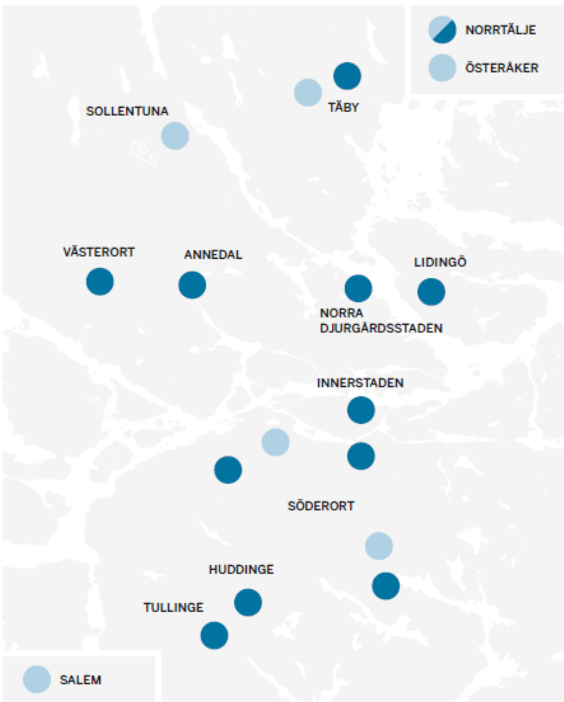
We find that Heba's properties are in attractive locations in the greater Stockholm area

Figure 2: Property portfolio distribution by geography (2020)



Source: Company reports

Figure 3: Map of greater Stockholm and Heba's properties

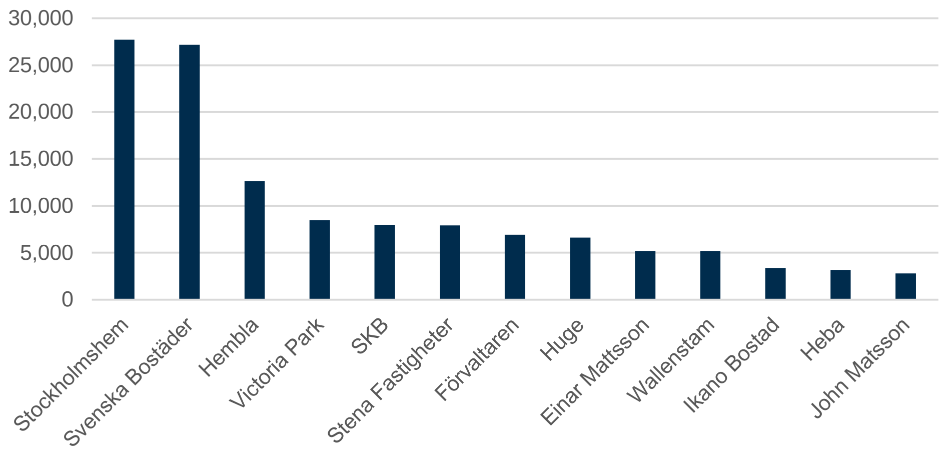


Source: Company reports
Note: Dark blue represents residential apartments; light blue represents community service properties.

Heba's relatively small size is a minor offsetting factor to its credit strengths, in our view

Heba is a relatively small player in the Stockholm residential segment, which is still dominated by municipality-owned property companies (Figure 4). Although company size is often considered in the credit markets, and by rating agencies, we do not view this as a substantially restrictive factor when considering Heba's credit profile. Given that we deem the locations of Heba's properties attractive, and given the modernisation of its portfolio alongside the controlled development of new attractive rental and community service properties, we believe that there is a very low risk of vacancies and potential loss of rental income ahead. However, if the Swedish rental market were to be de-regulated, which we consider as a quite unlikely possibility, we believe that Heba would be able to charge significantly higher rents for most, or perhaps all, of its rental apartments.

Figure 4: Selected private and municipality-owned housing owners



Source: Company reports, Handelsbanken Capital Markets
Note: Stockholmshem, Svenska Bostäder and Huge are municipality-owned.

Controlled development strategy should strengthen Heba's portfolio further

Heba is focused on improving and modernising the property portfolio

Heba has limited development risk, in our view. Ongoing refurbishment, readjustment and modernisation of the property portfolio is a key component of Heba's strategy in order to meet tenant demand and improve the attractiveness of the properties, thereby increasing the rental value and yields. Current investments amount to SEK 1.5bn. Heba's strategy is primarily to build, acquire and develop properties in areas where it already has a presence, although it has identified some municipalities as particularly appealing for an entry. During 2020, Heba acquired two development projects in Norrtälje and Österåker, north of Stockholm, as well as an elderly care property in Salem, south of Stockholm. Heba has also started a joint venture with Åke Sundvall Byggnads AB, primarily for the construction of tenant-owned co-operative apartments. The total development portfolio consists of around 20 projects (including planned starts), with a potential of about 1,600 apartments.

Table 1: Heba's project portfolio

Project	Apartments	Type	Completion	Investment (SEKm)
Hökarängen	84	Youth apartments	Q2 2020	140
Silverdal	52	Rental apartments	Q4 2020	179
Täby Park	142	Rental apartments	Q4 2020	449
Österåker Näs	80	Elderly homes	Q2 2021	222
Vallentuna	60	Elderly homes	Q2 2021	235
Vallentuna	64	Rental apartments	Q2 2021	168
Norrtälje Hamn	143	Rental apartments	Q3 2021	409
Norrtälje Hamn	167	Elderly/rental apartm.	Q2 2022	484

JV Projects Åke Sundvall (50/50)	Apartments	Type	Completion	Investment (SEKm)
JV Bredäng	200	Co-ops	Q4 '22 - Q1 '23	500
JV Uppsala, N. Rosendal	304	Co-ops/rental	Q4 2022	640
JV Vårbergstoppen	300	Co-ops	Q4 2022	600
JV Stora Sköndal	600	Co-ops/rental	2026 - 2027	2,000
JV Skarpnäck	100	Co-ops	2025	N.A.

Source: Company reports

In addition to new construction and acquisitions, Heba continuously modernises and refurbishes its existing portfolio, typically resulting in capital expenditure of about SEK 200m per year. According to Heba, refurbished rental apartments usually allow for a rent increase of around 50%, which is normally accepted by tenants. We believe that Heba's growth and investment strategy is sound and controlled. In our view, it should improve the overall quality of the existing portfolio while raising rental income and operating margins ahead.

Sustainability integrated in company strategy

Heba has set several measurable ESG targets

We find that sustainability, expressed through the environmental, social, governance and financial dimensions, is integrated in Heba's long-term strategy, property management and development practices. Heba has set several firm, measurable targets within each of these dimensions in order to grow in a sustainable and financially sound manner. In January 2021, Heba published its new green financing framework, under which green bonds and green loans will issued. Heba has a long-term goal of becoming climate-neutral by 2045. To reach this, it has set targets, including an aim to reduce its energy consumption in heating by 20% by 2028 (with 2018 as a baseline). As of December 31, 2020, Heba had already achieved a reduction of more than 10%, and it monitors its energy consumption in order to improve. Heba is achieving the reduction through refurbishing older properties, changing ventilation systems and improving insulation. In addition, it is making investments in renewable energy, such as geothermal plants in combination with solar panels, and Heba requires its new-build properties to qualify for a Miljöbyggnad Silver rating or similar. We believe that Heba's focus on sustainable growth is credible, and its green financing framework, as well as the contemplated green bond issuance, should sharpen this further.

Recent changes to historically stable ownership structure

Descendants and family members of the founders remain in control of the company

Heba was listed in 1994, but the company continues to be controlled by descendants of the two founders (Karl Holmberg and Folke Eriksson) who control the majority of votes through A-shares. Swedish real estate peers SBB (rated BBB-) recently bought a 21% stake (representing 11% of the votes) from the investment company Carlbergssjön, becoming the largest owner in terms of capital. We believe the historically stable ownership structure remains credit-supportive, with descendants controlling more than 50% of the voting shares, and we attribute Heba's historically low risk appetite and steady performance to this structure. However, SBB's large stake adds some uncertainty, as SBB is a lower-rated company with very high, publicly communicated, growth ambitions.

Table 2: Heba's ownership structure

	A-shares	B-shares	Capital	Votes
SBB	0	17,014,280	20.6	11.0
Birgitta Maria Härnblad	2,230,320	8,029,968	12.4	19.6
Charlotte Ericsson	974,160	4,314,372	6.4	9.1
Christina Holmbergh	924,160	3,909,804	5.9	8.5
Anders Eriksson	914,160	3,634,423	5.5	8.3
Ulf Ericsson	0	3,200,000	3.9	2.1
Margareta Sundström	953,520	1,945,980	3.5	7.4
Didner & Gerge Fonder	0	2,735,551	3.3	1.8
Johan Vogel	298,800	1,517,040	2.2	2.9
Anna Vogel	298,800	1,481,040	2.2	2.9
Others	1,396,400	26,787,222	34.1	26.4
Total	7,990,320	74,569,680	100	100

Source: Company reports, Bloomberg
Note: As of March 31, 2021

Demand for rental apartments should remain high

Rents in Sweden are usually determined through negotiations between landlords and tenant representatives; there is no role in the proceedings for public stakeholders, such as the central government or municipalities. The negotiation system is reinforced by national consumer protection for private tenants. Generally, higher property prices and long queues for municipality-owned accommodation have resulted in strong demand for rental units, a trend we believe is likely to be sustained ahead. High Stockholm land prices and municipalities' monopoly on city planning are likely to continue to dampen the pace of new developments, in our view, implying that the housing deficit should persist for some time yet before demand and supply become balanced.

Significant rental housing shortage in a regulated market

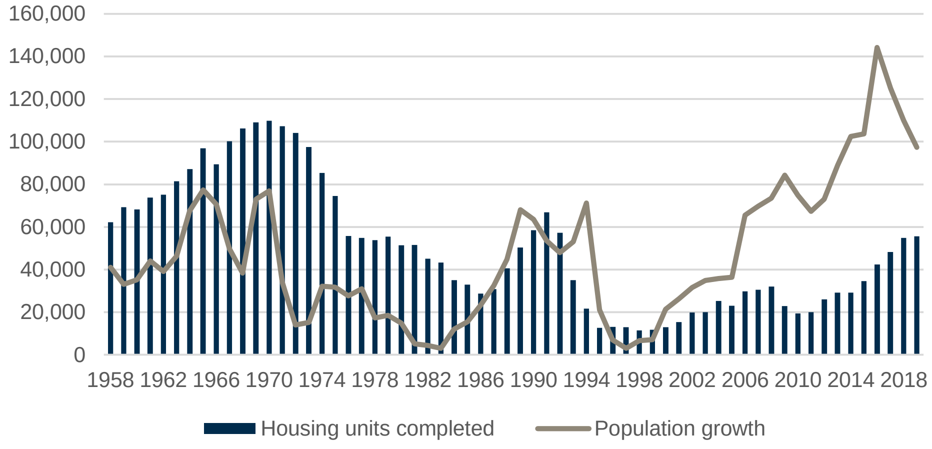
The negotiation system is regulated, with roots in the 1950s

Sweden's system of setting rents is based on negotiations between tenants and landlords. It was developed in the 1950s. 'Landlords' initially comprised only community housing corporations, but private landlords were included in the 1970s. The landlord is sometimes represented by a property-owners' organisation. Tenants are generally represented in the negotiations by a tenant organisation that has been assigned to protect the interests of the tenants. The negotiation system is regulated by the Rent Negotiation Act, which identifies the requirements of the different parties.

Partly owing to regulations, housing construction has remained low since the economic and real estate crisis in the early 1990s. At the same time, housing demand has risen sharply thanks to significant population growth in the last 20 years. In addition, construction of new housing has been tilted towards tenant-owned co-operative apartments, as returns are higher compared with rental apartments. Since 2018, more construction and real estate companies are now focusing on construction of rental apartments in the wake of tighter amortisation rules lowering demand for new tenant-owned co-operative apartments.

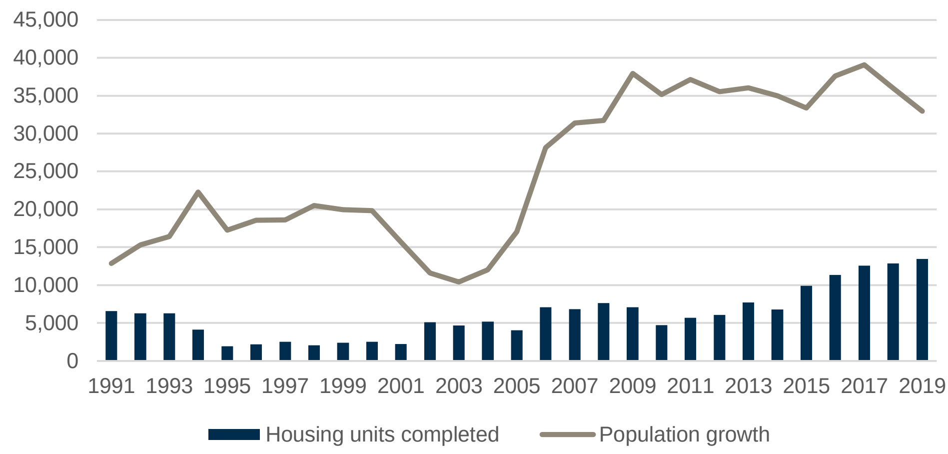
Housing construction has lagged population growth since the mid-1990s

Figure 5: Housing units completed vs. population growth, Sweden



Source: Statistics Sweden (SCB), Handelsbanken Capital Markets

Figure 6: Housing units completed vs. population growth, Stockholm

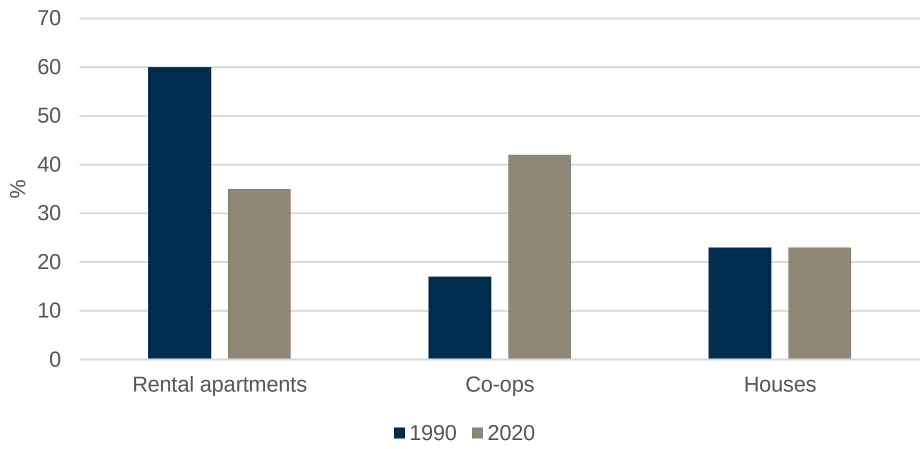


Source: Statistics Sweden (SCB), Handelsbanken Capital Markets

Housing shortage larger in Stockholm than rest of Sweden

People moving to Stockholm, or any other part of Sweden, face two main housing options: buy or rent. Housing can be bought, as it can in many parts of the world, through a real estate agent, or privately by mutual agreement using a binding contract that stipulates price and specifies terms. Housing prices have risen sharply over recent years, making the option more expensive than it once was. As many rental apartment properties have been transformed and sold, thereby becoming tenant-owned co-operatives, the share of rental apartments in Stockholm has fallen sharply in the last 30 years, which has increased demand for affordable rental apartments even further.

Figure 7: Breakdown of housing by type in Stockholm



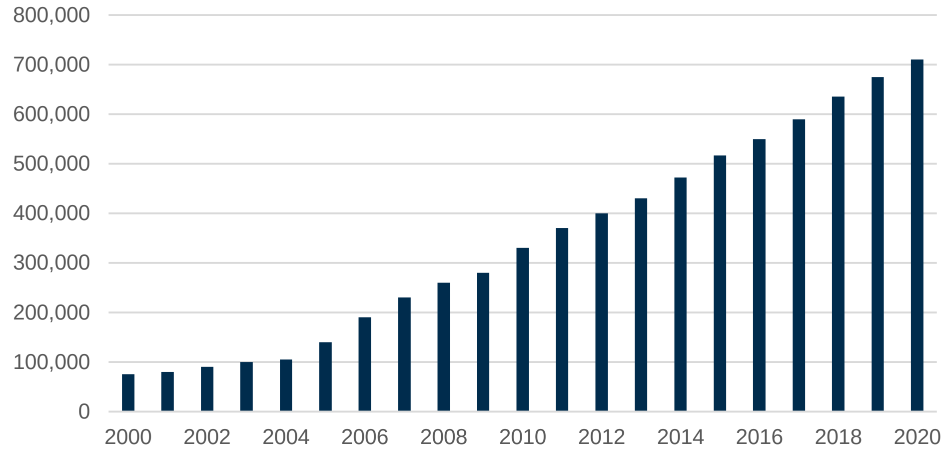
Source: Statistics Sweden (SCB), Handelsbanken Capital Markets

Substantial drop in rental apartments as a share of total housing in Stockholm

One option in the Stockholm region is to rent through the Stockholm Housing Agency, or Bostadsförmedlingen, which is a housing agency publically owned by the city of Stockholm (Heba's apartments are part of the agency's offering). The process starts with the applicant registering in a queue. Applicants in the queue are offered apartments as they become available. According to Bostadsförmedlingen, it delivers new housing to 12,000 applicants per year. However, the queuing time is generally very long. In 2020, the average waiting time for a rental apartment was about 10 years, with more than 700,000 people in the housing queue.

More than 700,000 people in Stockholm's public housing queue

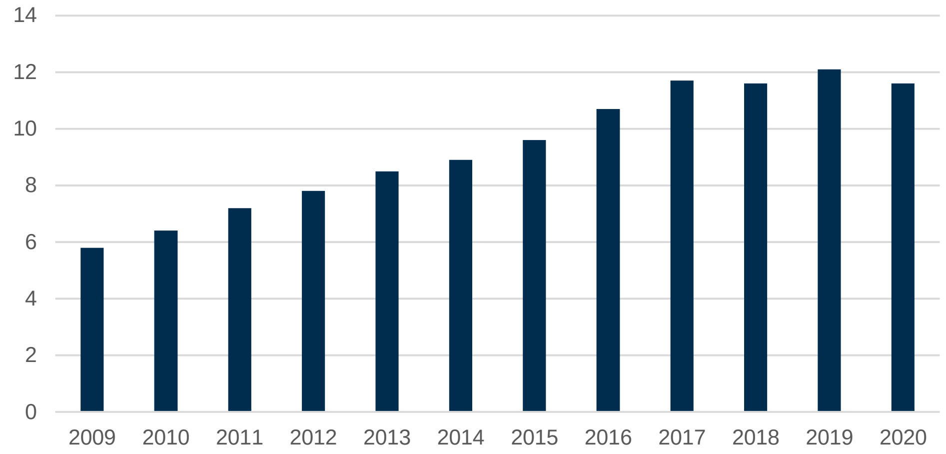
Figure 8: Number of people in Stockholm's rental apartment queue



Source: Stockholm Housing Agency, Handelsbanken Capital Markets

Average waiting time to rent an apartment in Stockholm is 10 years

Figure 9: Average waiting time, rental apartments, Stockholm



Source: Stockholm Housing Agency, Handelsbanken Capital Markets

In our view, the strong demand for rental apartments in Sweden partly stems from the rent regulations implemented in the 1950s, as regulation has resulted in rents falling substantially below what we deem to be market rents. With new regulations for the tenant-owned co-operative market recently introduced (minimum amortisation requirements and stricter income multiples), we expect the relative attractiveness of rental apartments in good geographical areas to increase relative to purchasing/ownership.

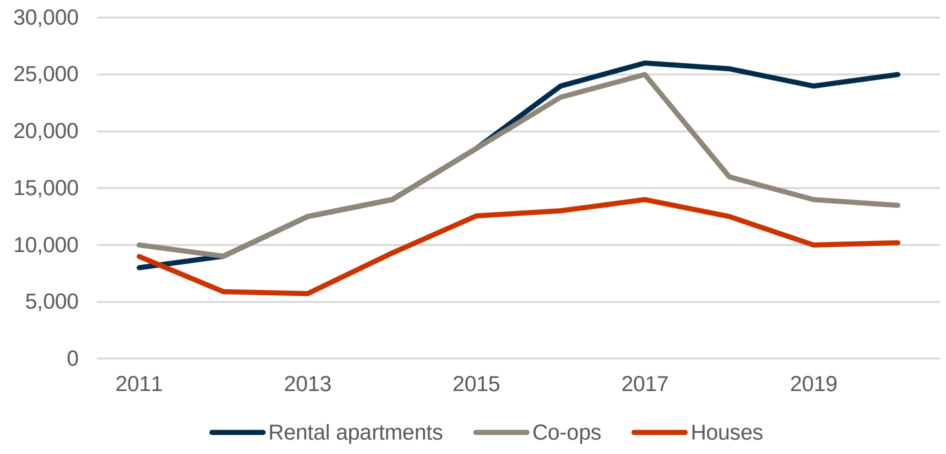
In September, the Swedish Board of Housing, Building and Planning (Boverket) presented a report with new housing shortage calculations, with the aim of studying how many households have an inadequate housing standard. According to the report, in 2018 there were 462,000 households that were overcrowded, 56,000 of which had stretched housing finances. The proportion of overcrowded households was highest in Stockholm County. If we look at housing construction in relation to population growth in each county, the major cities are where construction has been low since the 1990s.

More than 60,000 new housing units needed yearly to meet demand

While construction of rental apartments has remained fairly stable in recent years, partly fuelled by government investment, the building of tenant-owned co-operative apartments has fallen by about half since 2017. Boverket estimates there were around 54,000 housing unit starts (rentals, co-ops and houses) in Sweden in 2020, of which 11,000 were in Stockholm. For Stockholm, this is lower than in recent years (14,000-16,000), which we partly attribute to uncertainty in the wake of the COVID-19 pandemic. Boverket has calculated that 592,000-664,000 housing units need to be built in Sweden in the next 10 years to meet demand. This translates into 59,000-66,000 units per year, the majority of which would need to be in Sweden's larger cities. Despite the high demand, Boverket expects housing construction to be lower in 2021 vs. 2020.

Housing starts have fallen, partly owing to pandemic-related uncertainty

Figure 10: Housing starts by type, Sweden



Source: Statistics Sweden, Boverket, Handelsbanken Capital Markets

Given a rapidly growing population, general urbanisation trends and the number of households growing faster than completed units, we find that rental demand in Stockholm is high. Heba's prime areas are attractive, in our view, given their location (typically, relatively close to Stockholm city centre). Therefore, we believe the company can comfortably increase the number of apartments in its portfolio without incurring an increase in vacancies, given the strength of demand, lack of rental units and long queue for rental accommodation. The company's historical average vacancy rate is very low, basically only affected by people being evacuated during renovations.

Stable credit quality in the real estate sector

Generally, we find that Swedish real estate companies presented solid credit metrics and sufficient liquidity throughout 2020. While some uncertainty remains owing to the ongoing pandemic, we view the downside risk to credit quality as limited. Moreover, we believe that the Riksbank's bond purchasing programme limits upside risk to credit spreads. To date, the negative economic effects from the pandemic have been primarily borne by companies with activities linked to restaurants, hotels and retail. While we acknowledge that real estate companies are exposed to these segments to various degrees, that is not enough to alter our stable overall view of the sector. In our view, the vast majority of credit ratings remain stable and credit metrics are well within the demands of rating agencies. We expect the trend towards more public ratings in the sector to continue.

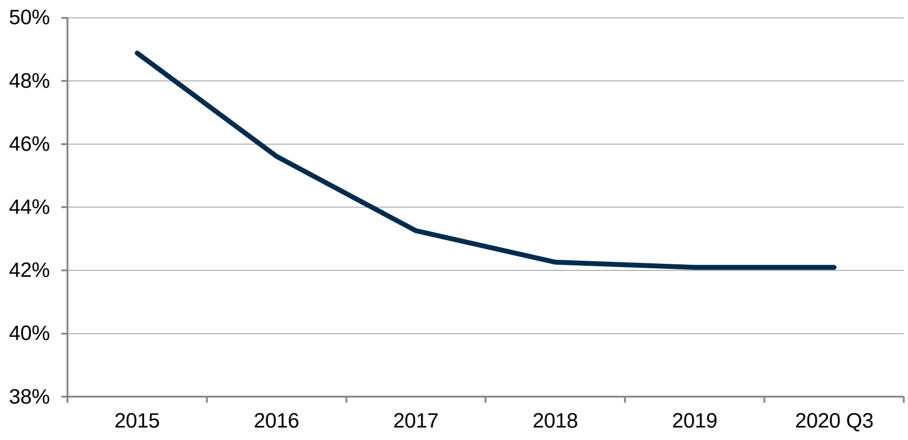
The primary credit metric, loan-to-value, remains stable

Loan-to-value (LTV), a highly watched credit metric, has steadily been falling over the past ten years in Sweden, which we primarily attribute to lower interest rates (and consequently lower property yields) boosting property values. The largest rises in property values in Sweden have occurred in bigger metropolitan areas; however, most geographical areas (and sub-sectors) in Sweden have enjoyed the benefits of falling interest rates. In recent years, rising rents have increasingly contributed to strong growth in property values. During 2020, rents and property yields remained broadly stable, which we believe should persist heading into 2021.

After analysing changes in property values in Sweden during 2020, it is quite clear that the negative impacts that may have been feared in March, at the outset of the COVID-19 pandemic, did not materialise. To date, the only writedowns recorded relate to sectors directly affected by the pandemic, such as hotels, restaurants and retail. Office property values have typically been stable, whereas the values of residential and community services properties are rising. For Heba, which is primarily a residential player with a low LTV of 41%, we deem the risk of falling property values as quite low.

We expect LTVs to remain stable going into 2021

Figure 11: Average adjusted LTV (total debt-to-total assets)



Source: Handelsbanken Capital Markets, company data

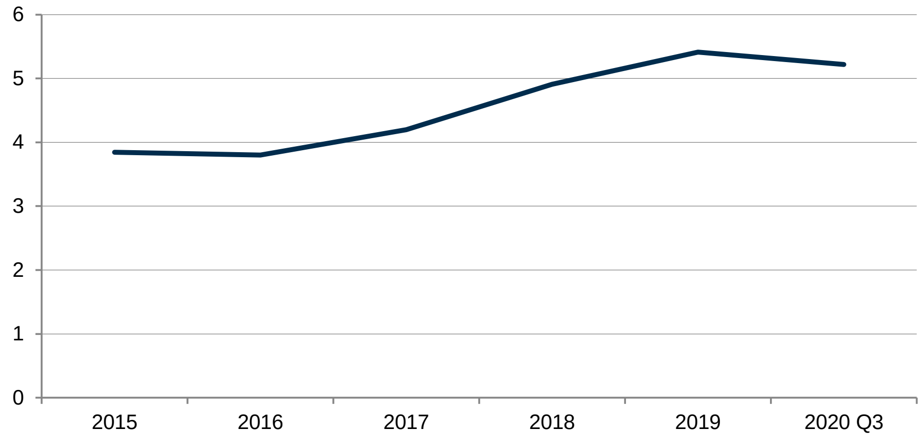
Note: Companies included are Atrium Ljungberg. Balder, Castellum, Fabege, Fastpartner, Hufvudstaden, Humlegården, Kungsleden, Vacse, Vasakronan, Wallenstam and Wihlborgs

Interest coverage remains strong

We find that interest coverage ratios (ICRs) have remained strong throughout the Swedish real estate sector. Falling interest costs, rising rental income and higher profit have resulted in average EBITDA-to-interest costs of about 5.0x, which is typically twice what most issuers outline as their minimum in their financial policies and what rating agencies demand for current ratings. Given continued low interest rates, well-functioning capital markets and stable profit generation, we believe the trend will persist in 2021.

We find that ICRs remain strong throughout the Swedish real estate sector (average close to 5x)

Figure 12: Average EBITDA-to-interest costs, adjusted

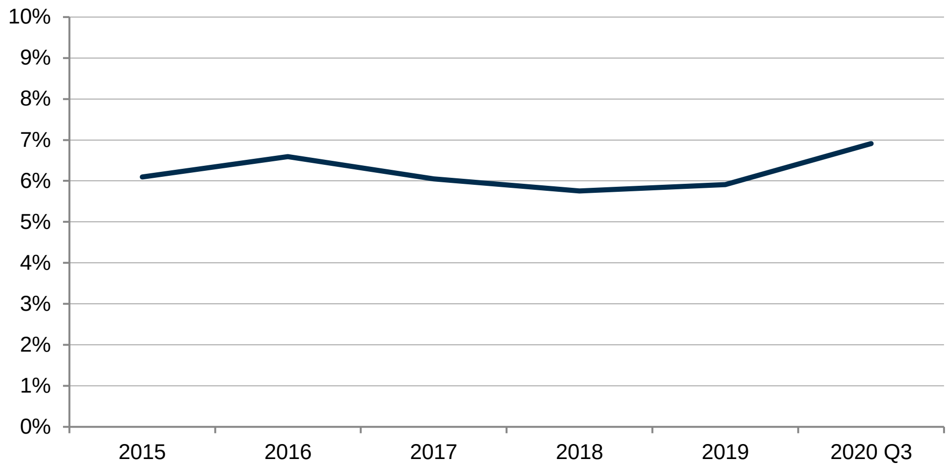


Source: Handelsbanken Capital Markets
Note: Companies included are Atrium Ljungberg. Balder, Castellum, Fabege, Fastpartner, Hufvudstaden, Humlegården, Kungsleden, Vacse, Vasakronan, Wallenstam and Wihlborgs

Vacancy rates remain low, but are rising slowly

On September 30, 2020, the average vacancy rate (including project and development properties) had increased by 0.8% from December 30, 2019. While vacancy rates remain relatively low in Sweden, they are increasing owing to the economic impacts of the pandemic and behavioural changes within the retail and office sectors. We believe real estate companies will have to focus even more on tenant demand; vacancies could differ significantly between attractive and less attractive properties, thereby affecting rents and valuations. However, for residential apartments, we believe vacancies will remain quite low, as they are not impacted by these trends in the same ways.

Figure 13: Average vacancy rates



Source: Handelsbanken Capital Markets
Note: Companies included are Atrium Ljungberg. Balder, Castellum, Fabege, Fastpartner, Hufvudstaden, Humlegården, Kungsleden, Vacse, Vasakronan, Wallenstam and Wihlborgs

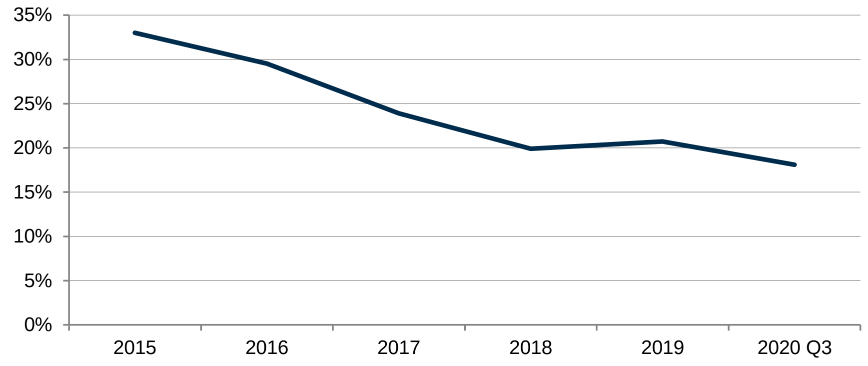
Market funding continues to grow in a crowded SEK market

We expect real estate issuers' share of market funding to continue to rise. The proportion of secured debt (typically bank debt) relative to total assets is currently below 20%. We do not expect an increasing number of real estate companies to tap bond markets. The number of public ratings is also increasing rapidly: more than 80% of bonds issued by real estate companies are from rated issuers, a figure we believe will continue to rise ahead.

As Nordic and global capital markets are swamped with liquidity and as central banks (including the Riksbank) are buying bonds, we expect the trend to continue. In our view, the Swedish bond market is starting to become crowded; during H2 2020, the share of real estate issuers in the SEK market grew to around 60%, which negatively affected credit spreads compared with other sectors.

Share of market funding continued to grow at the expense of bank debt, we believe

Figure 14: Average secured debt-to-total assets



Source: Handelsbanken Capital Markets

Note: Companies included are Atrium Ljungberg. Balder, Castellum, Fabege, Fastpartner, Hufvudstaden, Humlegården, Kungsleden, Vacse, Vasakronan, Wallenstam and Wihlborgs

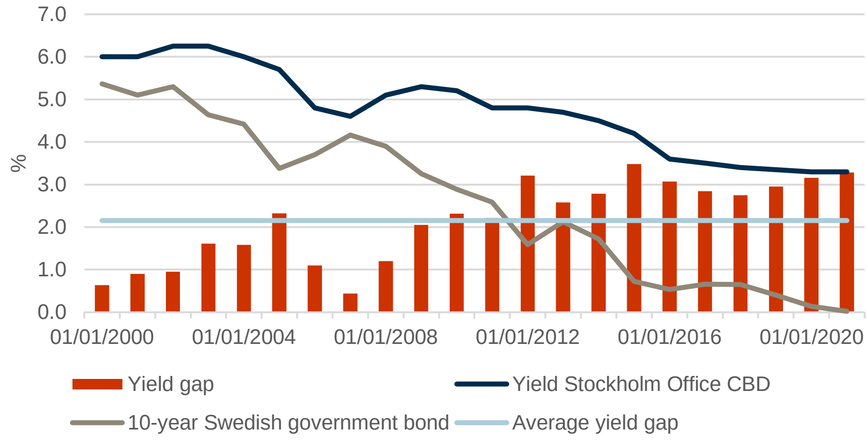
Higher unemployment on the cards, but interest rates likely to remain low

Slower economic environment offset by stimulus and low interest rates

Handelsbanken's macroeconomists expect the Swedish economy to rebound in 2021, and fears of a large recession have eased. However, unemployment is expected to rise, which could have an impact on the commercial property market. While it remains quite difficult to assess the economic outlook, we believe that demand for Heba's residential and real estate assets should be unaffected. While the economic outlook remains somewhat clouded, the view on Swedish and global interest rates (i.e. rates will remain very low) remains firm. Low interest rates have been, and will likely remain, positive for the real estate sector. The 'yield gap' (Figure 15: the difference between long/typically government interest rates and property yields) is at its highest yet; in our view, this should result in continued investor interest in Swedish real estate assets. We also believe international interest in Swedish real estate properties will continue to increase, as the country is deemed to be more stable, politically and economically, than others in Europe.

The property yield gap should provide a valuation cushion even as the economic outlook slows, we deem

Figure 15: Property yield gap



Source: Handelsbanken Capital Markets

Financial policy and funding

In our view, Heba has a long track record of generating stable results while retaining a strong balance sheet, solid credit metrics and moderate leverage. We find that its reported LTV of 41% is among the lowest within the broader Swedish real estate sector. Even though we expect Heba's leverage to increase somewhat as its pace of acquisitions and development accelerates, we believe that its overall financial risk should remain low. We find that Heba's relatively strong A- rating, assigned by Nordic Credit Rating in May 2020, provides further support to its credit profile.

Financial policy

We consider Heba's leverage targets as conservative

We expect Heba to continue to grow its rental income at a steady controlled pace while retaining and improving its operating margins. We also expect Heba to retain moderate leverage, albeit slightly higher than 40% owing to an increased pace of controlled development and acquisitions.

Heba's financial, operational and environmental targets include:

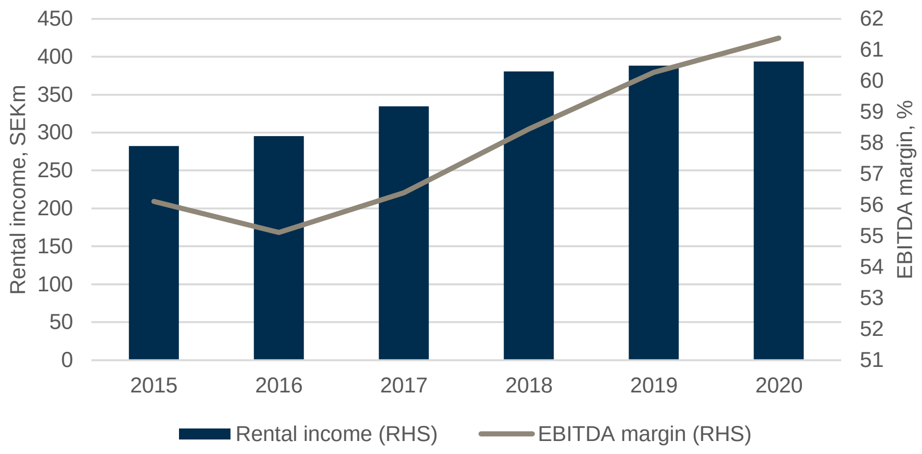
- An equity ratio of more than 40% (48% reported as of end-2020);
- LTV of less than 50%;
- A dividend payout ratio of 70%;
- A maximum of 20% community service properties in its portfolio;
- A 20% reduction of energy consumption by 2028; and,
- Climate-neutrality by 2045.

Moreover, Heba has measurable goals for customer and employee satisfaction and an increasing number of sustainability goals.

Controlled growth and improvement of operating margins

Heba has demonstrated steady rental income growth in recent years. Through expansion, modernisation and refurbishment of the portfolio, the company has also gradually increased its operating margins.

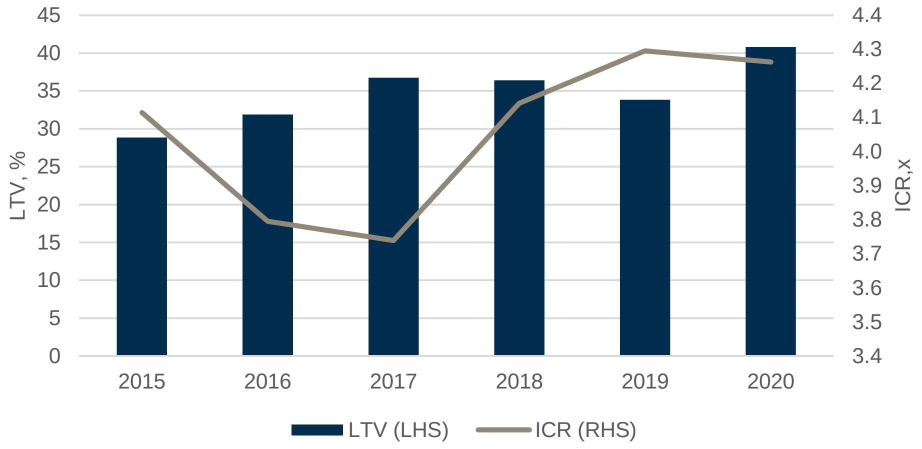
Figure 16: Heba's rental income and EBITDA margin



Source: Company reports

In our view, its credit metrics have remained strong, including LTV of 30-40%, one of the stronger figures within the broader Swedish real estate market.

Figure 17: Heba's LTV and interest coverage (ICR)



Source: Company reports

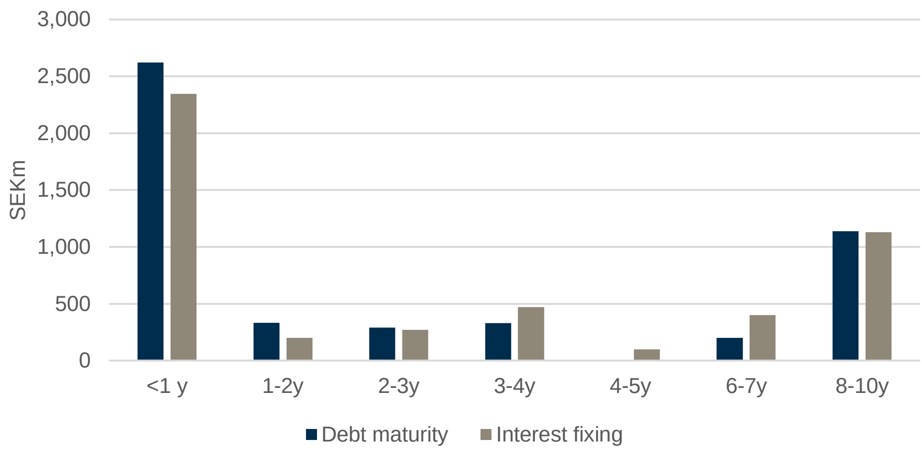
The share of unsecured debt will likely increase, we believe

Increasing share of unsecured funding

Heba has historically relied on banks for its funding. Looking ahead, Heba is contemplating to increase its share of market funding by issuing bonds under its recently published MTN programme, in addition to its existing commercial paper programme. As of December 31, 2020, interest-bearing debt amounted to SEK 4,915m, of which SEK 1,600m was related to commercial paper. In order to reduce the interest-rate risk, Heba has entered into interest rate swaps at a value of SEK 1,650m. The average interest rate was 1.15% at the end of 2020, the average debt maturity stood at 4.0 years, and the average interest fixing at 3.4 years.

In February 2021, Heba successfully issued green bonds with three and five years maturity amounting to a total of SEK 1.3bn, with credit spreads of 45bp and 70bp respectively. The bond issuance should extend the debt maturity profile (Figure 18) and lower the average interest rate. In addition, NCR assigned an A- rating to the bonds, equal to the company rating, as it believes Heba will increase its unsecured funding to 50% of total funding by the end of 2021. This is in line with what management has communicated. We view Heba's liquidity profile as adequate, with sufficient credit and overdraft facilities to cover upcoming commercial paper maturities, in the event of market disruptions.

Figure 18: Debt maturity schedule, Q4 2020



Source: Company reports

Credit view

In our view, Heba has one of the stronger credit profiles within the Swedish real estate sector. With a portfolio of attractive residential rental and community service properties, combined with modest leverage, stable ownership structure and a long track record of controlled growth, we find that Heba's credit profile compares favourably even with a broader Nordic real estate peer group. We acknowledge the company's small size and limited geographical diversification, as well as its relatively short debt maturity profile, as offsetting factors, but we find that these are relatively minor drawbacks compared with its strengths.

Supportive factors for Heba's credit profile – our view

We argue that Heba has an attractive property portfolio and a long track record of controlled growth and modest leverage

- An attractive residential real estate portfolio in the greater Stockholm area, where demand for residential housing remains high
- A growing share of modern community service assets, including elderly care properties, group housing, and day-care facilities
- A long and solid track record of controlled growth while retaining modest leverage
- A strong balance sheet, including a modest loan-to-value of 41%
- Good access to liquidity and capital through banks and through debt and equity markets
- A stable ownership structure, controlled by descendants of the company's founders
- Credible sustainability targets covering environmental, social and governance issues

Restrictive factors for Heba's credit profile – our view

We consider its small size and low diversification as restrictive factors

- The company is relatively small and has limited geographical diversification
- Exposure to changes in Swedish rental regulation legislation
- Rental income is to a large extent dependent on rental negotiations with tenant organisations
- Relatively high share of short-term debt, although we would expect this to be refinanced with longer-maturity debt ahead
- Increased share of development projects
- Swedish real estate peer SBB (rated BBB-) recently bought 21% of the shares (representing 11% of the votes), which adds some uncertainty in regards to the ownership structure

Modernisation and portfolio investment should strengthen the credit further, in our view

We believe that Heba's strategy of continuously modernising and expanding its already strong property portfolio should strengthen its overall credit profile. Moreover, we are encouraged to see that the environmental, social, governance and financial dimensions of sustainability are embedded in Heba's strategy and its operational and financial targets.

Peer group analysis and rating considerations

Heba was assigned an A- rating by Nordic Credit Rating in May 2020. We believe that Heba's A- rating compares well with other highly rated Swedish real estate peers. We acknowledge that Heba differs from those peers owing to its smaller size, but we argue that is offset by its strong financial risk profile.

Table 3: Selected credit metrics for Nordic real estate peers, Q4 2020

Solid A- rating compares well with peers, we find

	Heba	Vacse	Stenvalvet	Rikshem	Hemsö	Vasakronan
Rating	A-	A-	BBB+	A3	A-/A	A3
Outlook	Stable	Stable	Stable	Stable	Stable	Stable
Property value (SEKbn)	12.0	6.9	13.2	52.0	62.2	162.0
LTV (%)	40.8	39.0	45.0	51.0	60.0	42.9
ICR (x)	4.3	5.6	5.6	3.7	4.5	4.0
Debt/EBITDA (x)	21.0	9.8	10.0	15.2	16.5	14.7
Secured debt /assets (%)	25.9	15.0	23.0	9.2	0.0	6.2

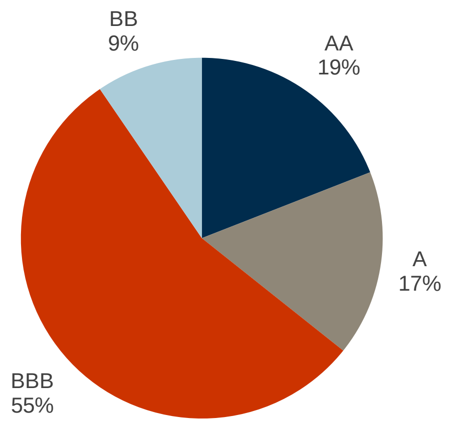
Source: Company reports, Handelsbanken Capital Markets.

We note that most rating agencies view residential real estate assets favourably, particularly Swedish regulated rental assets. S&P typically scores residential assets “Strong/A”, and Moody’s refers to the regulated Swedish residential sector as “one of the strongest asset classes in Europe”. We believe that investor sentiment towards well-managed residential real estate assets is similar.

Heba is one of few A-category rated, non-government-related issuers in Nordic real estate

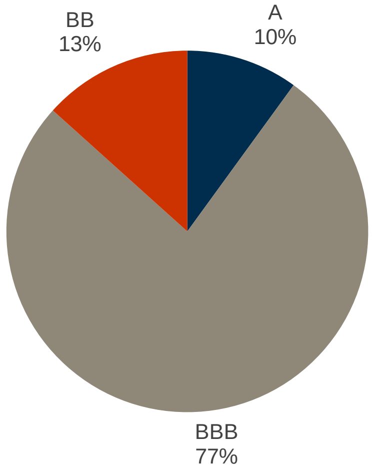
At present, there are 42 publicly rated real estate companies (including government- and municipality-related issuers) in the Nordics, most of which are in Sweden (37). Currently, only 9% have speculative-grade composite ratings (in the case of split ratings, the lower rating applies). If we exclude the 13 government-related issuers (which typically enjoy rating support from the rating agencies), we note that there are only three, or 10% of these issuers, that are rated in the A-category (Figure 19). We argue that Heba being one of few A-category rated real estate issuers in the Nordics is supportive to our view that Heba is a strong credit. The rating outlooks are overwhelmingly stable, with negative outlooks only attached to property companies that have high exposure to retail (Figure 21).

Figure 19: Rating distribution Nordic real estate, all issuers



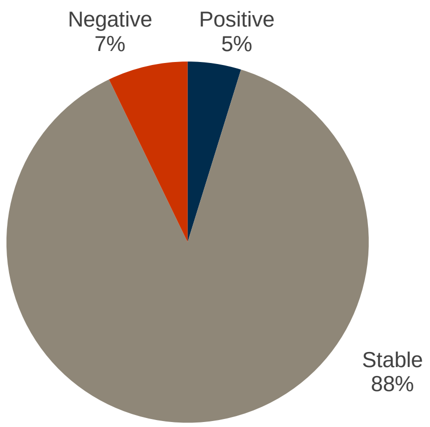
Source: S&P, Moody’s, NCR, Fitch, Scope, Handelsbanken Capital Markets

Figure 20: Rating distribution Nordic real estate, excluding government-related issuers



Source: S&P, Moody's, NCR, Fitch, Scope, Handelsbanken Capital Markets

Figure 21: Rating outlook distribution, Nordic real estate, all issuers



Source: S&P, Moody's, NCR, Fitch, Scope, Handelsbanken Capital Markets

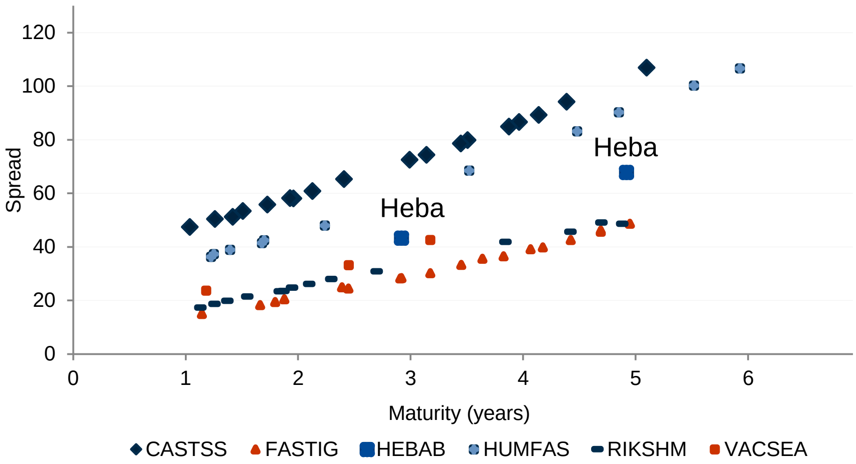
Relative value

We initiate coverage on Heba with a Market Perform recommendation on its SEK senior unsecured bonds. We think that Heba's limited size and track record in the Swedish bond markets is fairly reflected in the spreads.

Size and track record fairly reflected in bond spreads

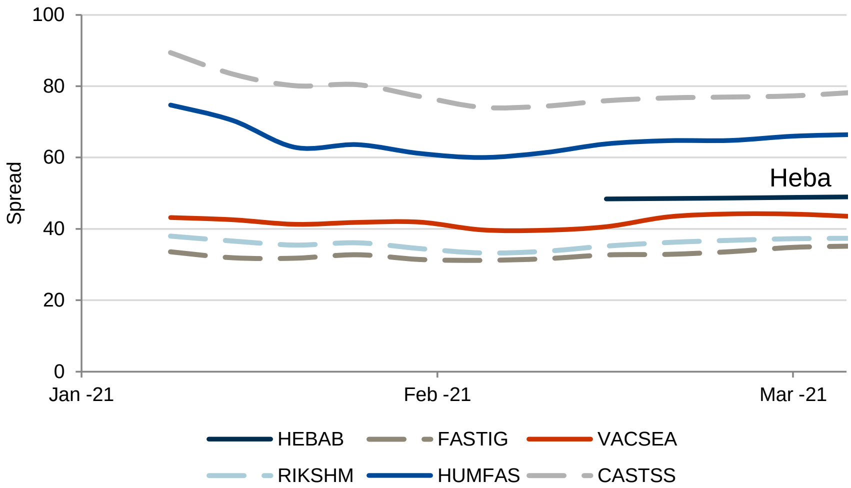
Heba's bonds (maturing in three and five years respectively) are currently trading slightly outside similar rated, significantly larger peers such as Vasakronan/FASTIG (A3) and Rikshem/RIKSHM (A3), as well as smaller peer Vacse/VACSEA (A-). However, Vacse has a longer track record in the Swedish bond market. At the same time, Heba's bonds are trading inside office-heavy, lower rated Humlegården/HUMFAS (Baa2) and Castellum/CASTSS (Baa2), which we think is fair.

Figure 22: Relative value SEK bond spreads



Source: Handelsbanken Capital Markets, Bloomberg

Figure 23: Historical SEK bond spreads, three-year interpolated (bid)



Source: Handelsbanken Capital Markets, Bloomberg

Key figures

P&L accounts, annual data

SEKm	2016	2017	2018	2019	2020
Revenues	295	335	381	388	394
Total op expenses	-134	-148	-160	-157	-154
EBITDA	163	189	222	234	242
EBITDA adj	163	189	222	234	242
EBIT	162	187	221	232	240
Interest income	2	1	2	1	4
Interest expense	-43	-51	-54	-55	-57
EBT	440	471	724	781	910
Paid tax	-0.6	0.4	-	-1	0.1
Net income	373	368	654	724	718

Source: Company reports and Handelsbanken Capital Markets

Balance sheet, annual data

SEKm	2016	2017	2018	2019	2020
Financial assets	0.0	0.0	30	34	334
Total tangible assets	7,529	8,775	9,661	10,300	12,220
Total intangible assets	2	2	3	2	2
Other long-term assets	2	2	3	2	2
Other current assets	50	21	25	37	122
Cash and equivalents	2	6	6	25	97
Total assets	7,582	8,804	9,724	10,399	12,776
Equity	3,991	4,293	4,873	5,506	6,125
LT interest-bearing debt	1,911	2,473	2,101	1,770	2,461
ST interest bearing debt	490	755	1,437	1,747	2,621
Other current liabilities	105	108	112	122	102
Total equity and liabilities	7,582	8,804	9,724	10,399	12,776
Total equity and liabilities adj	7,582	8,804	9,724	10,399	12,776
Total debt	2,401	3,228	3,538	3,517	5,082
Total debt adj	2,401	3,228	3,538	3,517	5,082

Source: Company reports and Handelsbanken Capital Markets

Cash flow, annual data

SEKm	2016	2017	2018	2019	2020
Funds from operations (FFO)	123	145	163	170	187
FFO adj	123	145	163	170	187
Change in working capital	28	27	7	2	0.6
Operating cash flow (OCF)	151	173	170	172	188
Cash flow from investments	-720	-784	-377	121	-1,273
Capex	-718	-927	-327	-606	-1,270
Dividends paid	-62	-66	-74	-91	-99
Discretionary cash flow	-629	-821	-232	-525	-1,182
Net change in debt	487	827	311	-179	1,556
Cash flow from financing	425	761	207	-275	1,157
Net cash flow	-144	150	0.2	18	72

Source: Company reports and Handelsbanken Capital Markets

Key metrics, annual data

%	2016	2017	2018	2019	2020
EBITDA adj margin	55.1	56.4	58.4	60.3	61.4
EBIT adj margin	54.8	55.8	58.0	59.7	60.9
Equity ratio	52.6	48.8	50.1	52.9	47.9
Equity ratio adj	52.6	48.8	50.1	52.9	47.9
Net debt/equity (x)	0.60	0.75	0.72	0.63	0.81
Net debt/EBITDA (x)	14.7	17.1	15.9	14.9	20.6
Net debt/EBITDA adj (x)	14.7	17.1	15.9	14.9	20.6
Debt/EBITDA (x)	14.7	17.1	15.9	15.0	21.0
Debt/EBITDA adj (x)	14.7	17.1	15.9	15.0	21.0
EBITDA/net interest adj (x)	4.0	3.8	4.3	4.4	4.6
EBIT/interest (x)	4	4	4	4	4
FFO/net debt	5.1	4.5	4.6	4.9	3.8
FFO/total debt adj	5.1	4.5	4.6	4.8	3.7
FFO/net debt adj	5.1	4.5	4.6	4.9	3.8

Source: Company reports and Handelsbanken Capital Markets

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HCM recommendation[1]	HCM universe main[2]	IB services[3]
Underperform	12%	14%
Market Perform	58%	29%
Outperform	30%	28%

[1] Recommendation definitions:
Outperform: Over the next 12 months, the bond's total return is expected to exceed the total return of the relevant benchmark
Market Perform: Over the next 12 months, the bond's total return is expected to be in line with the total return of the relevant benchmark
Underperform: Over the next 12 months, the bond's total return is expected to be below the total return of the relevant benchmark
[2] Percentage of companies under coverage within each recommendation
[3] Percentage of companies within each recommendation for which investment banking services have been provided in the past 12 months

Source: Handelsbanken Capital Markets, as per 6/4 2021

Recommendations are continuously reviewed by the analyst and monitored by the Research Management and will be updated and/or refreshed regularly. The rationale behind a change in recommendation will be explained in such a refresher/update.

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Heba Fastighets AB

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Mar 30. 2021:
Heba Fastighets AB
- Handelsbanken's analyst Michael Andersson has no position in Heba Fastighets AB or a related instrument.

The recommendation (SEK Senior unsecured) Market Perform was set on 2021-04-07 as the first recommendation for the company.

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Credit Research

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