FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Nordic Citycon at 'BBB-'; Outlook Stable

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Fitch Ratings - Stockholm - 19 May 2021: Fitch Ratings has affirmed real-estate group Citycon Oyj's Long-Term Issuer Default Rating (IDR) at 'BBB-'. The Outlook is Stable. A full list of rating actions is available below.

The affirmation reflects Citycon's operational performance, which has been better than many European peers' during the Covid-19 pandemic. Rent collection rates have remained high, above 95% in 2020 (1Q21: 92%) as have occupancy rates (1Q21: 94%), while rental relief granted to tenants has been manageable. Its rental income resilience is linked to its exposure to necessity-based and some public- sector tenants, the Nordic governments' comprehensive support for tenants, less severe lockdowns imposed and its exposure to Nordic consumers.

Citycon entered the pandemic with higher leverage than many investment-grade peers (end-2019: 10x net debt/EBITDA). We forecast this to return to 10x in 2022 when its large Lippulaiva development is completed and to remain below our 10.5x downgrade rating sensitivity (using annualised rents) in 2023 and 2024, aided by planned disposals (including building rights).

Feedback

KEY RATING DRIVERS

Outperformed Peers During Pandemic: As for all retail landlords, the impact of the pandemic on Citycon has been material. Tenants have been under financial pressure due to lower tenant sales, government restrictions and disruption to their operations. Nordic retail tenants have only been partly compensated by government support and rent relief granted by landlords. In comparison Citycon has performed better than European/UK peers. The pandemic's impact on 2020 net rental income was EUR13.5 million (6% of unaffected gross rents), including rental discounts granted (EUR4.4 million, related to 2Q20), credit losses, and volume-driven income such as car parking. Its 1Q21 occupancy rate declined to 92% (end-2019: 95%).

Rental Declines Less Severe: Unlike its UK peers the fall in its retail rents during 2020 and 2021 has been comparatively modest. Citycon's average rents, using comparable exchange rates, fell 2%-3% in 2020. Tenant sales and footfall - two key indicators for tenants' financial performance and future rents- held up well during the pandemic. Like-for-like tenant sales were down 3.7% in 2020, despite a 16.8% fall in footfall, reflecting a higher share of 'mission shopping' and higher sales per visit. Performance was aided by stores remaining open and less severe lockdowns being implemented by Nordic governments versus European peers.

Gradual Recovery Expected: Fitch expects the gradual reopening of economies to improve landlords' and tenants' operational performance, aided by government stimulus and steady vaccine rollout. Fitch rates EMEA property companies on an annualised EBITDA basis in a post-lockdown environment rather than on temporarily high cash flow leverage in 2020 and 2021. Fitch-annualised EBITDA includes expectations of a subdued rental environment where rents adapt to lower levels and occupancy rates remain influenced by weakened tenants, and consumer demand is hit by higher unemployment rates.

Lippulaiva Development: Citycon's key 44,300 sqm shopping centre development, Lippulaiva in the Helsinki metropolitan area, is scheduled for completion in April 2022. The project was 76% pre-leased at average rents of EUR31 per sqm at end-1Q21, well above the group average, and 45% of the gross lettable area (GLA) has been reserved for grocery stores. Lippulaiva, which is intended as a prototype for its retail assets, is well-connected to public transport and situated in an area with high purchasing power. The project benefits from further expected residential developments in the area. Development risk is managed by its construction contract with Skanska, one of the largest construction companies in the Nordics.

Feedback

High Cash Flow Leverage: Net debt/EBITDA was high at 12.3x at end-2020 (end-2019: 10x) including Covid-19's impact on rental income. Management is committed to balancing its sizable development programme with asset disposals, and has indicated other potential balance-sheet measures. This, together with the completion of the Lippulaiva development in 2022, is key to restoring leverage to 10x. This is consistent with management target loan-to-value of 40%-45%. Fitch expects EBITDA net interest cover to remain comfortable at around 3x.

Uncertainty remains around the challenging retail environment and its impact on rents and occupancy, and around the timing and valuations of planned disposals. Positively, during 1Q21 Citycon completed the disposal of three shopping centres in Sweden for EUR149.7 million, confirming its latest book values.

Portfolio Focused on Capital Cities: Citycon's sizable retail property portfolio (EUR4.5 billion at share) is pan-Nordic, which provides geographical diversification across five countries including Estonia. The majority of assets are located in the growing Nordic capital regions or in the second-largest city in each country (Gothenburg, Tampere, Bergen), which have higher disposable income per capita than their country averages and benefit from urbanisation. The assets are typically grocery-anchored shopping centres, with a lower weighting in fashion and a broader necessity-based retail offer rather than a "destination" venue, and good access to public transport. The country mix consists of stable highly rated countries with growth prospects.

Unencumbered Asset Base: Citycon benefits from an almost fully unencumbered asset base, which improves contingent liquidity and enhances recovery prospects for unsecured creditors. The only pledged assets are three assets in Norway, which are pledged for one of two revolving credit facilities (RCFs; currently undrawn) and the part-owned Kista Galleria JV, which is separately funded and not consolidated. The group's unencumbered asset cover was 2.1x at end-1Q21.

Hybrid Notched-off the IDR: The current EUR350 million hybrid bond is rated two notches below Citycon's IDR and qualifies for 50% equity credit under Fitch's criteria. It reflects the hybrid's deeply subordinated status, ranking behind senior debt, with coupon payments deferrable at the discretion of the issuer and no formal maturity date. It also reflects the hybrid's greater loss severity and higher risk of non-performance relative to senior unsecured obligations.

DERIVATION SUMMARY

Citycon is one of the few Fitch-rated European (non-CEE) all-retail property companies with a Stable Outlook. This reflects a more conducive Nordic operating environment, Citycon's type of retail portfolio with less past years' excesses (occupancy cost, space etc) to work through, and headroom in its financial profile.

Citycon's property portfolio is smaller than higher-rated Unibail-Rodamco-Westfield (BBB+/Negative) and Hammerson Plc (BBB/Negative). Its shopping centres are convenience, grocery-anchored assets similar to IGD SIIQ S.p.A (BBB-/Negative) rather than the destination shopping centres that Unibail and Hammerson primarily own. Many are adjacent to transport hubs so they benefit from high footfall, not all of which are weekend high-spend consumers. Citycon's portfolio is located in more developed countries with higher disposable income per person than eastern European peers such as Atrium European Real Estate (BBB/Stable) or NEPI Rockcastle (BBB/Stable).

Citycon's net leverage, which was above 12x in 2020 and should settle around 10x in 2022, is higher than Hammerson's (below 9x) and Unibail's (around 9x after its debt reduction plan). All property companies benefit from comfortable interest cover ratios, as their average cost of debt is low.

Fitch has not applied the one-notch uplift to Citycon's senior unsecured rating. Its current portfolio mix includes smaller and more regional assets, which are considered less liquid than those of UK or French peers that benefit from the sector recovery uplift.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- The challenging post-lockdown retail environment implies low potential for rent increases, and subdued prospects for an improvement in occupancy rates. Fitch has not included an improvement in occupancy rate when economies reopen. An improvement in tenant demand for space or in rents could improve metrics beyond Fitch's rating case.

- Adverse impact from Covid-19 on net rental income limited to EUR5 million in 2021 (2020: EUR13.5 million) and none thereafter. Reflecting the group's vulnerable short average lease length, Fitch has reduced 29% of rents scheduled to expire in 2021 by 5%, and assumes 20% in 2022 to be flat rather than the standard 1.5% CPI increase.

- Annualised rental contribution from disposals is deducted from rental income in the year they occur to reflect the full impact on recurring rental income in year-end debt/EBITDA metrics.

- Development capex is balanced with disposals (EUR150 million completed in 1Q21) or other measures. Management has indicated potential further balance-sheet actions.

- Successful completion of Lippulaiva during 2022.

- EUR5 million of dividends/interest income on shareholder loans from JVs per year.

- Dividends paid at 80% of funds from operations (FFO).

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Net debt/EBITDA (including cash-paid interest under shareholder loans and recurring dividends from JVs and associates) sustainably below 9.5x

- EBITDA net interest cover remaining above 1.75x

- Improvements in portfolio quality, most likely via asset disposals of weaker-performing assets, and rental growth- enhancing investments in the property portfolio

- Unencumbered asset cover above 2.0x

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Net debt/EBITDA (including cash-paid interest under shareholder loans and recurring dividends from JVs and associates) above 10.5x

- LTV rising above 55%

- EBITDA net interest cover falling below 1.5x

- Assets performing worse than expected with further like-for-like rental decreases, falling footfall and tenants' sales

- Unencumbered asset cover falling below 1.5x

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: At end-1Q21, Citycon had EUR46.1 million in cash and EUR500 million in undrawn committed credit facilities (maturing in 2024) comfortably covering EUR94 million of commercial paper maturing in 2021 and EUR162 million of bonds maturing in 2022. Committed capex mainly relates to its Lippulaiva project.

During 2021, Citycon issued a EUR350 million seven-year green bond with a 1.625% coupon. The group's average debt maturity was 4.5 years at end-1Q20 (end-2020: 3.8 years) before taking into account the perpetual hybrid bond. The average cost of debt was 2.4% at end-1Q21.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Citycon Oyj	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable

ENTITY/DEBT	RATING			PRIOR
• senior unsecured	LT	BBB-	Affirmed	BBB-
• subordinated	LT	BB	Affirmed	BB
Citycon Treasury B.V.				

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 30 Apr 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Citycon Oyj	EU Issued, UK Endorsed
Citycon Treasury B.V.	EU Issued, UK Endorsed

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