S&P Global Ratings

RatingsDirect®

Research Update:

Finnish Real Estate Company Citycon Oyj Downgraded To 'BBB-/A-3'; Outlook Stable

Primary Credit Analyst:
Teresa Stromberg, Stockholm (46) 8-440-5922; teresa.stromberg@spglobal.com

Secondary Contact:
Franck Delage, Paris (33) 1-4420-6778; franck.delage@spglobal.com

Table Of Contents

Research Update:

Finnish Real Estate Company Citycon Oyj Downgraded To 'BBB-/A-3'; Outlook Stable

Rating Action Overview

- Finnish real estate company Citycon Ojy's 2018 operating performance and leverage metrics were weaker than we expected due to difficult market conditions.
- Because its portfolio lost value and the company disposed less assets than we forecast, it missed its loan-to-value (LTV) target of 45% and our 50% debt-to-debt-plus-equity ratio guidance for maintaining the rating. We expect the challenging market conditions to prevail and the debt-to-debt plus equity ratio to remain sustainably above 50%.
- We are therefore lowering our ratings on the company to 'BBB-/A-3' and our rating on its senior unsecured notes to 'BBB-'.
- The stable outlook indicates that despite weakening economic trends in its key markets, we expect the company's income to prove resilient over the next 12-24 months, based on a stable occupancy rate of 96%, its additional specialty leasing, and contributions from redevelopment projects.

Rating Action Rationale

Following Citycon's weaker-than-expected operating performance and credit metrics for 2018, we do not expect a substantial recovery in the near term. At the end of December 2018, Citycon reported further property devaluations and limited noncore asset disposals. As a result, its S&P Global Ratings-adjusted debt-to-debt and equity ratio rose to 51.2% (corresponding to a reported LTV of 48.7%), from 48.9% (46.7%) in 2017.

Citycon divested €89 million of noncore assets in 2018, far less than the €300 million we expected, and lower than the target it had publicly indicated. In addition, we had expected its portfolio revaluation to be broadly flat; in the event, its portfolio was revalued at €72.5 million less than before. The negative movement mainly stemmed from widening yields and falling like-for-like rental income in Finland, combined with negative currency effects.

We expect our adjusted debt-to-equity ratio to remain above 50% for the next 24 months. While Citycon has committed to lowering its planned capital expenditure (capex), we understand that it has decided to maintain its cash dividend payments, even though its current leverage ratio is above its publicly stated maximum target of LTV below 45%.

In our view, further negative portfolio revaluations are possible and we see uncertainty regarding the execution of asset disposals. Although the Nordics retail investment market is currently somewhat subdued, we do not expect Citycon to dispose of assets at a marked discount. We now assess Citycon's financial risk profile as significant.

Citycon has retained its strategic focus on strengthening its balance sheet. Going forward, it intends to achieve this by divesting additional noncore properties and limiting capex. As a result, we expect its debt-to-debt plus equity ratio to remain 51%-53% range; this is commensurate with a 'BBB-' rating.

We still consider Citycon to be well-funded for the next 12-24 months. It has good access to credit facilities and significant headroom under its debt covenants. Citycon refinanced some of its higher-yielding bonds in mid-2018, demonstrating its access to low-cost debt capital markets. As a result, its average cost of debt fell to 2.4% as of Dec. 31, 2018, compared with 2.8% in 2017. We expect the company's ability to cover its interest burden to remain good and that it will post an EBITDA interest coverage ratio close to 3x.

If the current tough market conditions continue, rental income and asset valuation could come under further pressure, in our view. Citycon's operating performance has remained weak and it has demonstrated lower resilience than we initially anticipated. We are revising down our assessment of Citycon's business risk profile to satisfactory because we consider its performance weaker than retail peers with strong business risk profiles. For example, peers Klepierre S.A. and Carmila S.A. are posting stronger organic revenue growth that exceeds the rent indexation effect by leveraging their better geographic diversity and asset locations.

The Nordic retail market has more supply than other European markets, exposing Citycon to higher competition risks. Total portfolio like-for-like net rental income decreased by 0.5% in 2018, mostly because like-for-like rental income fell by 4.9% in Finland, which represents 38% of the company's reported asset value. Significant new supply entered this market just as retail sales slowed down, making market conditions particularly tough.

Citycon's performance in Sweden, Denmark, and Norway enjoyed low but positive growth due to renegotiated lease agreements, indexation, and higher service charges. That said, we see a weakening economic trend in Sweden--we lowered our forecast for GDP growth to 1.6% from 2.2% in 2019 due to weaker expected private consumption and lower fixed investment. This, combined with declining consumer confidence and trends in e-commerce, will erode operational performance further.

We consider Citycon's focus on redeveloping and extending its largest shopping centers (for example, the new development of Mölndal and extension of Lippulaiva, and the planned Kista Galleria, Oasen, Liljeholmstorget Galleria, and Trekanten) to be positive for the company's organic growth over the medium term and should help it meet its target of having 80%-90% of its portfolio in prime assets in capital or major cities. Well-located retail assets that see high footfall generate more sustainable demand from retailers. However, weakening consumer confidence and retail sales trends in the Nordics will continue to weigh on Citycon's like-for-like net rental income growth in 2019-2020.

Citycon's major shareholder Gazit-Globe has continued to increase its total shares and votes in the company; as of Dec. 31, 2018, it owned 48.5% of the company, up from 44.6% in 2017. Although we believe that Citycon has retained its independence at the board level--it still enjoys two strong minority shareholders to mitigate Gazit's decision power--we remain cautious about the effect of increased interaction with Gazit. We see Gazit as slightly more aggressive than Citycon.

Outlook

The stable outlook reflects our view that the company should be able to generate resilient cash flows thanks to its stable and solid occupancy rates and intensifying asset management efforts. We think income from Sweden and Norway will likely support the company, enabling it to cope with continued weak demand in Finland and the Baltics. We anticipate that the company will maintain EBITDA interest coverage of close to 3x and debt-to-debt plus equity of 50%-53% over the next 12-24 months.

Downside scenario

We might could lower the rating if the company's credit metrics deteriorate further, so that debt-to-debt plus equity rises above 55% or EBITDA interest coverage falls to 2.4x or below. This could happen if asset valuations dropped significantly or the company shifted to a more-aggressive financial policy on leverage.

We could also lower the rating if market conditions deteriorate further and Citycon's operating performance is significantly weaker than we expect. Finally, we could see a downgrade should Gazit-Globe increase its shares and votes above 50%.

Upside scenario

We might consider raising the rating if the company's operating performance turned around and it showed sustainably positive like-for-like growth. An upgrade would also hinge on the company being able to restore its adjusted debt-to-debt plus equity to well below 50%, while its interest coverage ratio remained solid at current levels.

Company Description

Citycon is an owner, developer, and manager of urban grocery-anchored shopping centers in the Nordic and Baltic regions. It manages assets valued at approximately €4.6 billion in December 2018. Citycon is one of the leading shopping center owners in Finland and is among the market leaders in Sweden, Estonia, and Norway. At the end of December 2018, Citycon owned and managed 40 shopping centers and retail galleries, mostly in Finland, Sweden, and Norway.

Our Base-Case Scenario

Our base case is based on the following assumptions:

- Slightly positive like-for-like rental income growth of 0.4% over the next 12 months, thanks to increasing consumer price inflation and intensifying asset management efforts, partly offset by some negative rental reversion at lease renewal.
- Negative like-for-like portfolio valuation of about 1.5% per year in 2019-2020, reflecting ongoing market challenges.
- About €80 million in asset disposals in 2019, in line with the 2018 performance, declining to €70 million-€75 million going forward.

As a result, we arrive at the following credit metrics:

- An EBITDA interest coverage ratio close to 3x in the next two years; and
- Debt-to-debt plus equity to remain at 51%-53% for the next two years.

Liquidity

We currently assess Citycon's liquidity as adequate. In our opinion, liquidity sources will exceed uses by more than 1.2x.

Principal liquidity sources for the 12 months from Dec. 31, 2018, include:

- Funds from operations of €130 million-€150 million
- €530 million of undrawn credit lines maturing beyond a 12-month time horizon; and
- Unrestricted cash balances of €4.2 million at the Citycon level, as of Dec. 31, 2018.

Principal liquidity uses as of the same date include:

- Debt maturities of about €176 million at the Citycon level, which includes debt outstanding under its commercial paper program;
- Planned capex of €116 million; and
- Cash dividend payments of more than €115 million.

Covenants

We expect covenant headroom to remain adequate, and a substantial majority of the assets to be unencumbered.

Issue Ratings - Subordination Risk Analysis

We lowered the issue rating on the unsecured notes to 'BBB-' from BBB, in line with the rating on Citycon. Although this action follows our downgrade of Citycon, we continue to see limited structural subordination on the unsecured bondholders. This is mostly because Citycon's proportion of secured debt is significantly lower than 40% of its total asset value, our threshold for notching down an issue rating under our real estate methodology.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/A-3

Business risk: Satisfactory
- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria

- Criteria - Corporates - Industrials: Key Credit Factors For The Real

Estate Industry, Feb. 26, 2018

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Citycon Oyj		
Issuer Credit Rating	BBB-/Stable/A-3	BBB/Negative/A-2

Downgraded

	To	From
Citycon Oyj		
Senior Unsecured	BBB-	BBB
Citycon Treasury B.V.		
Senior Unsecured	BBB-	BBB

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.