

Research Update:

# Finland-Based Retail Property Owner Citycon Outlook Revised To Stable From Negative; 'BBB-/A-3' Ratings Affirmed

June 22, 2021

## Rating Action Overview

- We believe Citycon's recent hybrid issuance of €350 million has reduced risks to the company's financial profile, and we now forecast our adjusted debt-to-debt-plus-equity ratio will remain slightly below 50% for 2021-2022.
- Despite still-challenging retail conditions, we anticipate continued high rent collection, as well as recovery in footfall and tenants' sales as macroeconomic fundamentals and consumer sentiment improve in the Nordics.
- We are therefore revising our outlook on Citycon to stable from negative, and affirming our 'BBB-/A-3' long- and short-term ratings.
- The stable outlook reflects our view that Citycon's grocery-anchored retail property portfolio will allow for stable cash flows and sufficient headroom for its credit metrics, with debt to debt plus equity staying well below 55% and debt to EBITDA close to 10x-11x over the next 12-24 months

### PRIMARY CREDIT ANALYST

**Teresa Stromberg**  
Stockholm  
(46) 8-440-5922  
teresa.stromberg  
@spglobal.com

### SECONDARY CONTACT

**Franck Delage**  
Paris  
+ 33 14 420 6778  
franck.delage  
@spglobal.com

### ADDITIONAL CONTACT

**Industrial Ratings Europe**  
Corporate\_Admin\_London  
@spglobal.com

## Rating Action Rationale

**We believe Citycon's recent €350 million hybrid issuance has strengthened its balance sheet and demonstrates commitment to reducing leverage.** Citycon issued the hybrid bond on May 27, at a fixed rate coupon of 3.625% per annum until the reset date Sept. 10, 2026. We view as positive management's efforts to comply with its publicly stated target of a maximum loan-to-value ratio below 45% (corresponding to our adjusted debt-to-debt-plus-equity of below 50%). We understand the issuance proceeds will mainly be used for refinancing and investing in new developments that meet Citycon's green financing framework requirements. A current project includes the new urban center Lippulaiva in the greater Helsinki area, due to be completed in 2022 with about 44,000 square meters of gross leasable area.

**We now project our adjusted debt-to-debt-plus-equity ratio at 49%-50% in 2021-2022 compared with 52.9% as of March 31, 2021.**

In addition, over that period, we expect our net debt-to-EBITDA ratio for Citycon to move toward 10x-11x from 12.4x as of March 31, and EBITDA interest coverage to remain at 2.7x-3.0x or higher. Some of the negative effects from disposals will be offset by improving cash flows on the back of improving consumer sentiment, the new project Lippulaiva coming on stream in 2022, and stable average interest rates of 2.4% as of March 31, 2021.

**We assume further low-single-digit valuation declines in 2021 although Citycon's asset disposals and revaluations at the beginning of the year support current asset values.**

Our base-case scenario still includes a low single-digit revaluation decline in 2021, and flat in 2022 compared with a 3.5% drop in 2020. We anticipate that retail property owners, including Citycon, could experience lower asset valuations because appraisers may assume a potential reassessment of future cash flow or increased capitalization rates reflecting the prevalent negative sentiment in the European and Nordic retail markets. However, as of first-quarter 2021, Citycon had managed to sell three noncore shopping malls for a total of €147 million, which slightly exceeded the book value as of fourth-quarter 2020. Moreover, we note some signs of potential value stabilization for Citycon's assets, since the company reported a €8.5 million positive revaluation during the first quarter, after 15 successive quarters of negative revaluations. In our view, these transactions and recent revaluations support the current valuation and indicate that the transaction market for retail assets is slowly gaining momentum although we remain conservative in our assumption of Citycon's capital recycling over the next 12-24 months. Furthermore, we note that the high leasing activity in the first quarter, which resulted in a slightly positive average rent reversion may help protect the portfolio's value. Overall, we believe the retail market pressure has been captured in negative revaluations, although realized disposals should support Citycon's credit metrics.

**E-commerce and changing consumer behavior will continue to weigh on retail sales, especially in the Nordics where shopping center density and online shopping are already high, but the ongoing economic recovery should support rental income.**

Citycon continues to face operating pressures due to social-distancing measures, and in the first quarter it reported a decline in net rental income of 3.8%. Yet we understand the company did not provide any rent relief during the quarter and rent collection remains high compared with that of European retail peers at 96%. With some recent easing of restrictions in the Nordics, recent data shows footfall levels recovering, averaging 93% of the 2019 level (as of June 2021); in Norway and Estonia retail conditions are even better than in 2019. With the continued opening up of economies and an acceleration of vaccination programs in the Nordics, we expect the recovery to kick in in the second half of 2021. We project economic growth in the Nordics at 2.6%-4.5% in 2021 and 2022, partly thanks to strong expected exports and private consumption. For example, indicators show consumer confidence in Sweden at its highest in 11 years, which together with positive retail sales trends in the Nordics should support Citycon's like-for-like net rental income growth over the next 12-24 months.

**However, we view Citycon's focus on more resilient tenants as positive, even though revenue is not as predictable as in the past due to uncertainty regarding the pandemic.**

We believe that retail landlords' revenue and predictability are generally slightly weaker than in the past. Therefore, we view as positive the company's strategy with grocery-anchored tenants and its increasing share of public-sector tenants; we estimate about 35% of rental income is from nonretail assets. In the medium term, we expect Citycon to capitalize on its strategy to diversify

the portfolio into the more resilient residential sector, and decrease its exposure to retail. Even though the strategy would entail acquisitions, we understand it would extract building rights from existing assets, involving limited up-front capital expenditure (capex), and therefore have a negligible impact on credit metrics.

**We believe Citycon's liquidity and funding profiles should remain solid over the next 12-24 months.** The company enjoys a solid liquidity buffer with the ratio of uses over sources at 2x as of March 31, 2021. The company's debt repayments for the next 12 months total €255 million and relate mainly to €162 million bond maturing in September 2022 and €94 million of commercial paper. We understand the company intends to roll over existing maturities and refinance bonds with some of the proceeds from the recent hybrid issuance. Nevertheless, should market conditions become tougher, Citycon has €43 million of cash and cash equivalents and €500 million available under its committed undrawn backup facility as of first-quarter 2021 in addition to the recently issued hybrid of €350 million. Citycon does not face any significant debt maturity in 2023, and therefore we do not see any rating pressure in the near term stemming from the current liquidity position.

## Outlook

The stable outlook reflects our view that the company should be able to maintain a debt-to-debt-plus-equity ratio close to 50% over the next 12-24 months. We also anticipate debt to EBITDA returning to 10x-11x and EBITDA interest coverage to 2.7x-3.0x over that period. Furthermore, we expect Citycon's operating performance will continue to stabilize with improving footfall numbers and tenants' sales as the Nordic economies recover.

## Downside scenario

We could lower the rating if the company's credit metrics deteriorate further, with debt to debt plus equity surpassing 55% or the debt to EBITDA increasing beyond 12.5x. This could happen if asset valuations dropped significantly or the company shifted to a more-aggressive financial leverage policy.

We could also lower the rating if market conditions worsen and Citycon's operating performance is significantly weaker than we expect, or if Gazit-Globe were to increase its stake in Citycon and voting rights to above 50%.

## Upside scenario

We might consider raising the rating if the company's debt to debt plus equity fell to well below 50%, while our adjusted debt-to-EBITDA ratio reduces sustainably below 9.5x. An upgrade would also hinge on Citycon achieving a sustainable return to positive organic revenue and portfolio value growth, demonstrating stronger-than-anticipated resilience of its business model in the currently challenging retail environment.

## Company Description

Citycon is the owner, developer, and manager of urban grocery-store-anchored shopping centers in the Nordic and Baltic regions. It managed assets worth approximately €4.2 billion as of

first-quarter 2021. Citycon is one of the leading shopping center owners in Finland and among the market leaders in Sweden, Estonia, and Norway. Its shopping centers cater to consumers' daily needs. Citycon is listed on the Nasdaq Helsinki. The majority shareholder, Gazit-Globe, has a 49.2% stake in the company as of March 31, 2021.

## **Our Base-Case Scenario**

### **Assumptions**

- Slow recovery, with flat like-for-like rental income growth in 2021, owing to social-distancing measures in the first half of 2021.
- A stable occupancy rate of 93%-94%.
- A slight decline in EBITDA margins to 88%-89% for the next 12-24 months following active asset rotation and operating conditions that could lead to higher costs for the company.
- A 3% valuation decline in 2021 and flat after that, given continued tough retail market dynamics, although slightly better than for other European retail players, as shown by relatively stronger performance in 2020.
- Around €250 million of disposals in 2021 and an additional €50 million-€100 million in 2022-2023, in line with the company's plan to dispose of noncore assets.
- Development capex of €160 million-€180 million in 2021 and €100 million-€150 million annually in the next two-to-three years.
- Dividend payments of €85 million-€90 million in line with the company's plan.

### **Key metrics**

- EBITDA to interest coverage at 2.7x-3.0x or higher during 2021-2023.
- Adjusted debt to debt plus equity remaining at 49%-50% in 2021 and 2022.
- Debt to EBITDA of 10.0x-11.0x through 2023.

### **Liquidity**

We assess Citycon's liquidity as adequate. In our opinion, liquidity sources will exceed uses by about 2x over the next 12 months.

Principal liquidity sources include:

- Available cash of €43 million as of March 31, 2021.
- Undrawn credit lines maturing beyond 12 months of €500 million.
- Funds from operations of €110 million-€130 million.
- Committed asset sales of €147 million.
- Recent hybrid issuance of €350 million.

Principal liquidity uses include:

- Short-term debt repayments of about €255 million, including commercial paper of about €94 million.
- Development capex of €175 million-€180 million over the next 12 months.
- Dividend payments of €85 million-€90 million.

## **Covenants**

### **Compliance expectations**

We expect that Citycon's covenant headroom will remain adequate, and that the majority of its assets will remain unencumbered.

### **Requirements**

Citycon complied with the following financial covenants as of March 31, 2021:

- Net debt to total assets of less than 60% (45%);
- Interest coverage ratio of more than 1.8x (4.0x);
- Solvency ratio of less than 65% (46%); and
- Secured solvency ratio of less than 25% (4%).

## **Issue Ratings--Subordination Risk Analysis**

### **Capital structure**

Citycon has limited secured debt, and bank loans represented 4% of its total interest-bearing debt as of March 31, 2021.

### **Analytical conclusions**

We align our issue rating on the unsecured notes with our issuer credit rating on Citycon because we continue to see limited structural subordination for the unsecured noteholders. This is mostly because the proportion of secured debt is significantly lower than 40% of the total asset value, which is our threshold for additional notching to derive an issue rating. As of March 31, 2021, Citycon's secured debt represented less than 5% of its total asset value.

## **Ratings Score Snapshot**

Issuer 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)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

## **Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## **Related Research**

- Finland-Based Real Estate Company Citycon Oyj's Proposed Unsecured Subordinated Bond Rated 'BB', May 25, 2021
- Citycon Oyj, Sept. 22, 2020

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Citycon Oyj</b>		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3

### Ratings Affirmed

<b>Citycon Oyj</b>		
Subordinated	BB	
Junior Subordinated	BB	

### Citycon Treasury B.V.

Senior Unsecured	BBB-	
------------------	------	--

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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect 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.standardandpoors.com](http://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.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.