CALL ME MAYBE?

A CASE STUDY ON SBB'S HYBRID BONDS

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Master Thesis

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CALL ME MAYBE?: A CASE STUDY ON SBB'S ISSUANCE OF HYBRID BONDS

Abstract

This single-case study examines why Samhällsbyggnadsbolaget i Norden's (SBB) issued hybrid bonds, its implications, and the value this instrument generates for the corporation, shareholders, and investors. SBB's mission since the start has been to expand into one of the largest real estate companies in the Nordics, accompanied by an improvement in credit rating. This study aims to display an in-depth analysis of a real estate company's issuance of an un-traditional instrument to support its strategy and mission. We found that SBB's strategic choice of issuing hybrid bonds has proven historically advantageous, aligning with its objective of achieving a targeted credit rating and optimizing its capital structure. An investment-grade rating has been crucial for SBB, supporting its growth strategy, attracting international investors, and fulfilling investment mandates. The issuance of hybrid bonds has provided SBB with capital, higher credit ratings, the possibility of long-term financing, and equity-like features. We find support that the hybrid bonds have created value for shareholders by avoiding dilution effects and improving leverage ratios. However, the rise in interest rates has created market turbulence and uncertainties regarding the ability to call the hybrid bonds on the first call date, impacting SBB's financial profile and necessitating refinancing. On the other hand, we find that hybrid bonds still contribute to long-term financing and offer stability until the first call date in an uncertain market. However, caution is exercised due to uncertainties in high-interest environments and the company's strategy when approaching call dates. Further, hybrid bonds may become less popular due to difficulties surrounding the first call date, such as market conventions and costs. These uncertainties lead to difficulty in issuing new hybrid bonds to keep the equity ratio intact for credit rating purposes.

Keywords:

Hybrid Bonds, Real Estate, Credit Rating, Bond Market

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1. Introduction

Samhällsbyggnadsbolaget i Norden ("SBB") is a Swedish real estate firm founded in 2016. Since its establishment, SBB has grown rapidly and has become one of the leading real estate companies in the Nordics. SBB has, since the start, turned to the bond market for financing, marking a significant departure from traditional methods of capital raising in the real estate sector. During the last decade, there has been an increase in the volume of bonds issued by real estate corporations in Sweden. The Riksbank's monetary policy indirectly contributed to this shift by driving down long-term interest rates for low-risk investments such as treasury bonds and other low-risk interest-bearing investments. As a result, investors sought higher yields in other avenues. The increased demand from investors led to reduced credit risk premiums for commercial real estate companies, increasing demand for, e.g., bonds compared to bank debt (Scope, 2020).

In 2017, SBB emerged as one of Sweden's pioneering real estate companies to issue hybrid bonds (SBB, 2017b). This move mirrored the broader trend arising within the Swedish real estate sector, which has actively issued hybrid bonds. This financial instrument combines debt and equity elements, offering investors a distinctive blend of characteristics (Scope, 2020). Hybrid bonds have been popular for many years among companies in the utility and industrial sectors, and as of 2022, the European hybrid bond market reached EUR 175bn. With interest rates increasing and many call dates approaching, the previously standard way to refinance hybrid bonds by simply paying the investors back at the call date has become more difficult (Financial Times, 2022). This is not only due to the more expensive refinancing alternatives but also the challenges to keeping its rating intact by credit rating institutions. Simply calling the hybrid bonds without replacing them with other equity-like content may impact their rating (Fastighetstidningen, 2022).

This study explores the reasons behind SBB's decision to issue hybrid bonds and how these bonds have generated value for the company, its shareholders and investors. Henceforth, we have opted to conduct a case study, which is comprised of the following research questions, to demonstrate the functionalities, purposes, and options of hybrid bonds:

1. *Why did SBB choose to issue hybrid bonds, and what implications can the instrument have on the company?*

2. *How are the hybrid bonds generating value for the company, its shareholders, and investors?*

Our findings suggest that the issuance of hybrid bonds has been advantageous for SBB to move towards an investment grade rating and achieve its growth objectives. The company's ability to raise significant amounts of capital without adversely affecting its debt-to-equity ratio is partly due to its use of hybrid bonds. SBB has demonstrated innovation within its capital structure by using the appropriate capital sources based on market conditions. However, the company's reliance on traditional and hybrid bond markets has placed it in a unique position. The current high-interest rates have presented challenges for SBB, given its goal of achieving a solid investment-grade credit rating while expanding rapidly. Hence, the assessment of potential value added by the instrument is contingent upon prevailing market conditions. Additionally, the company might face complex challenges when the call dates approach, and refinancing other outstanding bonds and financial liabilities is needed before that. However, it is essential to point out how interest rate levels can change, which will impact the decisions SBB will make in the future. The issuance has created value for common equity holders by avoiding dilution when raising capital and simultaneously contributing to equity, improving its leverage ratios and credit rating. We suggest that SBB’s liability management regarding repurchases of hybrid bonds can raise questions if it is positive for more senior creditors in SBB but that it simultaneously improves the company’s financial stability.

This paper is written upon two purposes. Firstly, we study SBB’s issuance of hybrid bonds with the objective of getting in-depth knowledge about the background and the implications of issuing this instrument. Secondly, we aim that the case study bridges a research gap in the existing literature regarding the use of hybrid bonds in the Swedish market, particularly within the real estate sector, where the instrument has emerged as a relatively recent addition to the financial landscape.

Regarding limitations and scope, this paper focuses on the viewpoint of both the company and analysts due to the conducted interviews. We acknowledge that there may be other stakeholders with differing perspectives, but due to resource limitations, our scope is restricted to the available resources we have access to. Additionally, the case study methodology exhibits a drawback in its constrained ability to establish generalizable conclusions (Yin, 2014). As this study is limited to SBB's hybrid bonds, the findings may not be readily transferable to other situations. Nonetheless, the primary objective of this paper is to provide exhaustive insights into the background and implications of SBB's hybrid bond issuance, as opposed to primarily deriving broad conclusions about why corporations issue hybrid bonds. Nevertheless, it is plausible that our findings could be pertinent to using this instrument by other businesses, as they are likely to share certain characteristics.

In section 2, we will present relevant existing literature on the bond market, credit ratings, and hybrid instruments. The third section will detail our selected methodology. Section 4 will provide the reader with a market context, including the hybrid bond instrument and the IFRS classification, a concise introduction to SBB, and the rating agencies' methodology for assigning equity credit to the bond. Section 5 contains the case of SBB’s issuance of hybrid bonds. In section 6, we will discuss our findings, and in section 7, we will present our conclusions and recommendations for future research.

2. Literature review

2.1 Hybrid instruments

Vallée's (2019) paper illustrates how innovative liability instruments might help address, e.g., frictions for banks to access capital in stressed times. The author studies liability management exercises (LME) by banks made during the financial crisis in 2008, which have regulatory capital effects comparable to contingent capital triggers. The issuance of contingent capital instruments as part of balance sheet strengthening is stated to have significantly increased outside of the United States since 2009. These instruments are Basel III-compliant and trigger when a regulatory capital ratio drops below a certain threshold. Vallée (2019) describes that the most popular contingent capital instruments are Principal write-down bonds and Contingent convertibles (CoCos). Principal write-down bonds offer a reduction of the principal amount in the event of a trigger, while CoCos convert into common equity when triggered.

During the financial crisis, hybrid bonds issued by banks allowed for the practical use of LMEs. The banks issuing hybrid bonds decide whether or not to call the security at the first call date, delaying repayment for a long to an indefinite period if the security is not called, as well as the ability to defer coupon payments without triggering a default. These bonds can also be treated as capital under Basel II, categorized as either tier 1 or tier 2 capital based on their legal maturity and coupon payment terms. Historically, banks have called their bonds at par on the first call date, but during the financial crisis, rising refinancing costs prompted banks to rethink their call strategy. Banks had three options at the call date: call at par, not call, or not call and launch a tender offer at a discount. While calling makes economic sense for well-capitalized banks with bonds worth more than par, not calling creates economic value for banks with poor capitalization. Launching a tender offer at a discount can also generate economic value; the difference between the tender price and the nominal amount contributes to the core tier 1 capital and raises the core tier 1 ratio. In the financial crisis, several banks changed their call strategy and implemented liability management exercises by refusing to call them at par and launching significantly discounted tender offers.

The study demonstrates that non-bankrupt European banks are comfortable with imposing significant losses on subordinated debt holders, which helps them acquire additional core tier 1 capital but violates the absolute priority rule (equity holders bear losses before credit holders do). During the financial crisis, by using the threat of extending the maturity of the instruments, issuers have been able to tender large amounts of hybrid bonds, leading to a rise in the core tier 1 capital of European banks. This situation contradicts the common belief that banks are unwilling to impose losses on debt holders. The findings from Vallée (2019) indicate that banks that have recently implemented LMEs might face higher costs for the issuance of bonds compared to those that have not, suggesting a decrease in investor demand for these bonds. This outcome could be interpreted as a "punishment" meted out by investors to banks that violated the absolute priority rule by imposing losses on hybrid bondholders during LMEs or failing to meet their expectations.

2.2 Bond market and credit ratings

Baghai, Becker, and Pitschner (2022) state that credit ratings are used in a wide spread of funds marketed to consumers, institutional investors, ETFs, open-ended mutual funds, and income funds. The usage of ratings within funds has grown during the last decade, both in the U.S. and Europe. Within the paper's sample, the use of ratings in mandates increased from 90.0% to 94.4% in the U.S. between 2010 and 2020. For Europe, ratings rose from 46.8% to 65.8% between 2012 and 2021. The usage of credit ratings has been in the U.S. for over a century, compared to Europe, where it is relatively recent. The authors state that this might explain the lower usage of ratings in mandates in Europe. Worth noting is that the rating references in mandates have been strongly increasing during the last years, implying the growing importance of credit ratings. One driving factor to the increase could be the intense competition among mutual funds. The authors state that mandates make extensive use of credit ratings; they have an essential role in risk constraints among funds and can be used to attract investor capital. Lastly, the authors argue for an increase in the use of credit ratings in Europe due to, for example, increasing competition in the asset management sector.

2.3 Credit ratings and capital structure

Kisgen (2006) investigates how credit ratings directly impact capital structure decisions. Historically, corporations, for example, issue new shares and reduce debt to prevent credit rating downgrades. The author states that it is previously proven that credit ratings are the second most significant concern for CFOs when determining capital structure, implying that credit ratings play a crucial role when deciding the appropriate amount of debt. Furthermore, it is stated that credit ratings are ranked higher than factors suggested by traditional capital structure theories. Kisgen (2006) argues that managers' concern for credit ratings is linked to the discrete costs (or benefits) associated with various rating levels. Several regulations on bond investments are built directly on credit ratings since credit rating levels determine whether specific investor groups are permitted to invest in a company's bonds. Credit ratings can also work as a form of information to investors and therefore serve as a signal of firm quality.

The paper introduces two measures to differentiate between firms that are nearing an upgrade or a downgrade from firms that are not in close proximity to such changes. It is shown that concerns for the benefits of upgrades and costs of downgrades directly affect managers' capital structure decisions. Capital structure decisions are influenced by both the possibility of an upgrade and the risk of a downgrade, and the change from investment grade to high yield seems to be incrementally significant. These results are consistent with several of the hypotheses outlined on the importance of credit ratings for businesses. In addition, rating tests point to the fact that firms are most concerned about rating levels when it will severely affect access to commercial paper and bond liquidity (Kisgen, 2006).

Kisgen (2007) provides an overview of two fundamental theories on optimal capital structure: Modigliani and Miller's theory from the 1950s, which suggests that a company's value remains unaffected by its choice between equity and debt, and the Trade-Off theory by Kraus and Litzenberger from the early 1970s, which argues that each company has an ideal debt-to-equity ratio that maximizes its value. However, Kisgen (2007) notes that these prominent theories do not explicitly consider credit ratings. In addition, Kisgen (2007) emphasizes that companies now give greater consideration to the potential costs and benefits associated with credit ratings when determining their capital structure. This is attributed to the rating's indirect impact on the cost of debt capital, access to a broader investor base, and relationships with various stakeholders. Kisgen (2007) further finds that companies highly dependent on credit rating will put effort into receiving their target rating favourable for their business. Even though credit ratings are taken into much more concern than existing capital structure theories suggest, the paper argues that a capital structure policy must be designed for the firm in question. Firms too small for an investment grade rating or having no motive of accessing public bond markets serves no meaning in striving for high credit ratings. On the contrary, corporations that are active in and dependent on the public debt market or in an industry where credit ratings are crucial customer relationships will strive to achieve high credit ratings (Kisgen, 2007).

Furthermore, Rauh and Sufi (2010) researched the debt structure of rated public firms, which showed that debt heterogeneity is a first-order aspect of firm capital structure. As mentioned earlier, the pecking-order hypothesis and the trade-off theory are the two most popular justifications for differences in capital structures among enterprises. However, neither of these hypotheses is particularly effective in explaining the author's central finding that businesses simultaneously issue debt products from various reasons, sources, and priority structures. They found that senior unsecured debt and equity make up the majority of the funding sources for companies with high credit quality. On the contrary, firms of lower credit quality have substantially more spreading in their priority structure. In their research, they analysed “Fallen Angels”, companies downgraded from investment grade rating to high yield and found that before the downgrade, companies used similar capital structures as other companies in the downgraded rating segment. After the downgrade, the companies relied more on subordinated bonds and secured bank debt than comparable companies not downgraded (Rauh and Sufi, 2010).

3. Methodology

3.1 Empirical Methodology

With research questions based on *how* and *why*, a case study methodology is preferred. It also relates to a current set of events the researcher has minor control over (Yin, 2014). The case study methodology also helps researchers to conduct in-depth studies and gain comprehension of a particular context or organisation (Rashid et al., 2019; Siggelkow, 2007). To answer the research questions of this study, a single case study of the use of SBB's hybrid bonds was conducted. Due to the complexity, it was necessary to sacrifice width for depth to perform a single case study, even though several case studies would have offered circumstances for comparisons and hence a stronger foundation for theory development. Yet, a detailed description and comprehension of actual phenomena are more readily attained by a single case study (Eisenhardt & Graebner, 2007); hence, it is the technique of choice for our empirical setting and research issue. Moreover, case studies are regarded as helpful study tools since they offer a humanistic, comprehensive knowledge of difficult circumstances (Brown, 2008). A single case study is the best method for our empirical setting and research topic because it makes it easier to enable and describe a phenomenon in depth, acknowledged by Eisenhardt & Graebner (2007) and Merriam (1994).

3.1.1 Data

Our primary data sources comprise interviews with individuals covering and analysing SBB and public material. With interviews being one of our primary data sources, we concentrated on preparing, conducting, and analysing the results systematically. We chose to hold interviews with both dependent and independent interviewees to gather a comprehensive set of primary data that is diverse and trustworthy. Interviewees classified as dependent include those who have operational control over SBB. The collected data represent perceptions from various narratives and stakeholders throughout the case, which, when combined and given equal weight, should provide the study legitimacy and depth.

The interviews were semi-structured, which means that we prepared a list of questions to ask but allowed the session to develop conversationally (Merriam, 1994). The semi-structured interviews allowed us to adapt and change interview questions to account for fresh insights and the unique knowledge of the interviewee. Furthermore, the interviewees were free to stray from the interview framework and talk about their experiences and perspectives, which occasionally required that the talks take place outside the parameters of the interview guide (Bryman & Bell, 2015). Our interviewees consist of professionals holding different positions (see Table 1) and, therefore, knowledge, which we believe will create a diverse data collection and provide the most insightful information. The interviews were performed physically and virtually between the 3rd and 20th of April 2023, lasted 45 to 60 minutes, and were analysed in conjunction with the discussions and supplementary with questions if necessary.

Table 1: Summary of interviews

Interviewee Name	Company and Role at the Time of the Interview	Dependence	Date of interview
Interviewee 1	Anonymous, Equity Research	Independent	03.04.2023
Ylva Forsberg	Nordic Credit Rating, Credit Analyst	Independent	03.04.2023
Philip Hallberg	Lannebo Fonder, Portfolio Manager	Independent	05.04.2023
Michael Johansson	Arctic, Real Estate Research	Independent	05.04.2023
Interviewee 2	Anonymous, Capital Markets	Independent	11.04.2023
Marcus Gustavsson	Danske Bank Credit Research, Senior Credit Analyst	Independent	11.04.2023
Marika Dimming	SBB, Investor Relations and Head of Sustainability*	Dependent	20.04.2023
Helena Lindahl	SBB, Treasury Director**	Dependent	20.04.2023

**Resigned shortly after the conducted interview*

***Treasury Director and Head of Capital Markets and IR*

Source: Authors

3.2 Methodological Evaluation

The case study approach has been criticised for its lack of rigour and inability to generalise results (Yin, 2014). Moreover, Siggelkow (2007) cautions against taking broad conclusions from the analysis of a particular organisation. We are addressing the lack of rigour by adhering to a methodical process of working and well-defined research topics. The objective of this research is not primarily to generalise but rather to give in-depth information about a real hybrid bond case and its usage. In addition, while conducting interviews, the interviewees' responses may be prone to prejudice, poor recollection of historical decisions, and poorly formulated questions (Yin, 2014). Yin (2014) also addresses that using several data sources, also known as triangulation, is a suitable strategy for addressing the difficulties at hand. In addition to conducting interviews, we gathered supplementary information, e.g., public reports. This enables us to cross-check information with public data. Case study research may also be susceptible to a lack of reproducibility (Idowu, 2016). Unfortunately, we cannot guarantee that replicating this work will provide the same results, as they depend on the interviewees' replies and the current market environment, which may change.

4. Market Background

There has been a dynamic shift in using hybrid securities among real estate corporations in Sweden. In the past, Swedish real estate companies had grown accustomed to relying on bank loans for their financing needs. However, the aftermath of the global financial crisis brought about changes in international and local banking regulations. These changes raised capital requirements and elevated the cost of bank loans for companies. Consequently, corporate treasurers in Sweden, much like their counterparts in several European markets, have increasingly looked towards capital markets as an alternative funding source (Scope, 2020).

4.1 Hybrid bonds

There are numerous types of hybrid instruments, such as convertible bonds, exchangeable bonds, and bonds with equity warrants. For this case study, in line with the hybrid bonds issued by SBB, the emphasis will be on corporate hybrid bonds that are not convertible into equity. Notable is that the issuer and its financial advisors determined the terms and conditions of the hybrid bonds. Therefore, the pledges can vary in terms of mechanisms and obligations. We will discuss the IFRS and IAS 32 criteria that designate hybrid bonds as equity, as well as the contractual characteristics of the instrument. In addition, we will comment briefly on other hybrid instruments and compare their mechanisms.

4.1.1 Hybrid bond accounting standards

Hybrid bonds have the characteristics of both liabilities and equity. IAS No. 32 characterises financial liabilities as contractual commitments to transfer cash or any financial assets to another firm or to exchange financial instruments under potentially unfavourable conditions. An equity instrument is any contract that evidences a residual interest in an entity's assets after deducting all of its liabilities. (IFRS, n.d). Under IFRS and IAS 32, hybrid bonds are financial instruments with debt and equity characteristics. IAS 32 states that "*The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.*" (IFRS, n.d). Furthermore, IAS 32 states that financial instrument with liability can only be classified as equity if, and only if, it meets the following criteria:

1. The instrument includes no contractual obligation to deliver cash or another financial asset to another entity.
2. The instrument will or may be settled in the issuer's equity instruments, which is either: (i) *A nonderivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments* or (ii) *a derivative that will be settled only by the issuer's exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.*

4.1.2 Hybrid bond definition

The corporate hybrid bond debt component provides the investor with a fixed or variable rate of return. The equity component is that the obligations to pay such interest can be deferred, combined with the long (or even perpetual) maturity (Liberadzki and Liberadzki, 2016). Below we will present features for corporate bonds. Hybrid issues are generally rated two notches below senior ratings for investment-grade issuers and three notches below ratings for high-yield issuers (Danske Bank, 2022).

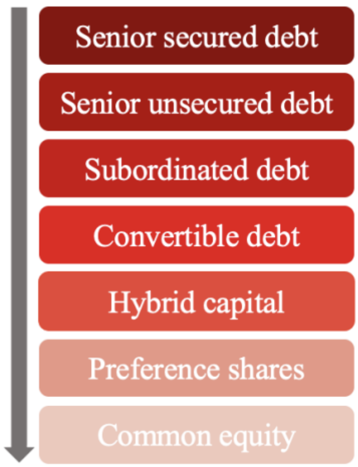
Maturity

When a nominal value should be returned to the creditor is determined by the maturity date of the debt. Bonds without an unfixed maturity date are called undated or perpetual bonds. Moreover, bonds with an exceptionally long maturity (30 years or more) are also regarded as hybrids because they provide financing for much longer than what is often thought to be long-term financing (5-10 years). Although the bond's maturity is perpetual or has a maturity of 30 years or more, the issuer can call the bond before the maturity date. The first call date often occurs 5-10 years after the bond has been issued (Liberadzki and Liberadzki, 2016). According to market convention, hybrids are often called at the first call date. It is not common for issuers not to redeem the bond, but it becomes more common during a recession and when issuers' ratings are reduced to a high yield (BNP Paribas, 2021). Not redeeming the bond on the first call date is typically followed by unfavourable outcomes for the issuer (e.g., coupon step-ups). Because of this, the issuer has a reason to redeem the securities at the call date, which lessens the hybrid's resemblance to equity (Liberadzki and Liberadzki, 2016).

Subordination

Hybrid bonds rank between senior debt and common equity in a firm's capital structure. This implies that in default, corporate hybrids would rank junior to the firm's other debt (Liberadzki and Liberadzki, 2016). In the balance sheet hierarchy, hybrid securities rank below non-deferrable subordinated loans. Thus, they are subordinate to only common equity and junior hybrids. Generally, a D-share will have less priority than hybrid bonds and preferred shares, both in terms of coupon payment and the event of a restructuring (Nordic Credit Rating, 2019).

Figure 1: Seniority structure



Source: Danske Bank, 2022; Authors

Step-up

During the non-callable period, lasting five to seven years, the investors are most often paid a fixed coupon rate. Usually, this implies a reference rate (e.g., Libor, Stibor and Euribor) plus an agreed-upon margin. After the non-callable period (if the bonds are not called), the coupon gets adjustable. Typically, the coupon resets to a swaps-linked coupon with a new call date and reset dates five years later. At the following call dates, coupons usually increase by 25 basis points and 75 basis points, respectively (Morgan Stanley, 2017). The primary purpose of step-ups is to incentivise the issuer to call or redeem at some time, which might dilute the perpetuation attributes following the long maturities (Scope, 2020). It is likely for the issuer to execute its call option if the spread at which the issuer can refinance is lower than the step-up plus the spread of hybrid at issuance.

Deferral

For a bond, anytime an issuer fails to make a scheduled coupon payment to investors, the corporation is in default, and investors are entitled to file for bankruptcy. Contrarily, common equity instruments do not have periodic payments, and the pay-out of dividends to shareholders is at the board of directors or shareholder's annual general meeting's (AGM's) discretion. Thus, the absence of a dividend pay-out is not considered a default and does not give rise to any shareholder claims. A corporation may simply stop paying dividends to shareholders during tough financial times (Liberadzki and Liberadzki, 2016).

Hybrid bonds have an equity-like feature, which is the potential for the issuer to forgo coupon payments during financial difficulty (Liberadzki and Liberadzki, 2016). Such a nature is needed for hybrid bonds to be qualified for equity content from credit rating institutions (e.g. Scope, 2020; S&P, 2022). Sometimes, without warning or default, coupon payments may be put on hold (cumulative deferral) or even cancelled (non-cumulative deferral). With cumulative deferral, the total amount of interest is due to the hybrid bondholders when the corporation begins to pay interest again. With non-cumulative deferral, this amount will not be paid out. In such scenarios, the company's challenging circumstances are paid for by its shareholders and bondholders acting as the company's creditors (Liberadzki and Liberadzki, 2016). Many hybrid bonds also bear interest on deferred coupons, which minimises the financial impact on the bond yields for investors (Morgan Stanley, 2017). Overall, there are two different types of deferrals that corporations can implement. One is a mandatory coupon deferral, and the other is an optional coupon deferral. The option closest to dividends is optional with non-cumulative deferral (Liberadzki and Liberadzki, 2016).

Tax deductible

Current Swedish law makes a clear distinction between two sources of "interest". It may be from an expense incurred on account of borrowed capital, which is subject to a tax deduction. Otherwise, it may arise from equity-related costs, such as dividends, which are not eligible for a tax deduction. Such legislation can differ between jurisdictions due to being subject to local tax regulations (Företagsskattekommitén SOU, 2014). For hybrid bonds, coupon payments are generally tax-deductible (Danske Bank, 2022) and treated as an expense incurred from borrowed capital.

4.2 Other common instruments in the real estate sector

4.2.1 Preferred stock

Preferred stock was a popular instrument among Swedish real estate companies before hybrid bonds (Scope, 2020). Since preferred stock shares similar characteristics to common stock and bonds, it is classified as a hybrid security (Nasdaq, 2016). These shares have a preferential dividend, and a specified amount of dividends must be given to the preferred shareholders before common shareholders can receive dividends (Schroeder, Clark, and Cathey, 2019). Like hybrid bonds, the issuers of preferred stock have the right not to pay dividends to the investors, and the investors have no resources if dividends are chosen not to be paid (Nasdaq, 2016). Preferred stock also holds seniority in any liquidation over common shareholders and often has no to sometimes special voting rights (Berk and Demarzo, 2017).

4.2.2 D-shares

D-shares are a sort of perpetual preferred stock without preference, and their dividends are linked to ordinary share pay-outs (often with an upper cap). The D-shares were created to replace preferred stock; the objective was to construct an equity-like instrument that offers a predictable cash flow, with the maximum dividend pay-out being the most probable result under normal business conditions (Scope, 2020).

The D-share class has come to be reserved for shares with a limited fixed dividend. The percentage is determined by each issuer and regulated by the Articles of Incorporation. D-shares function similarly to preference shares and have increasingly come to replace them. Not only do D-shares rarely have redemption criteria like preference shares, but they also do not accumulate missed dividends with interest. D-shares are used primarily by real estate firms (Affärsvärlden, n.d.).

4.3 Samhällsbyggnadsbolaget i Norden

In this section, we will provide a historical overview of Samhällsbyggnadsbolaget i Norden ("SBB"), founded in Sweden in 2016. This overview will serve as a foundation for analysing the company's utilization of hybrid bonds as an alternative form of funding to traditional debt and equity in the real estate sector.

4.3.1 Historical overview and business summary

SBB is a real estate company specialising in social infrastructure properties, such as healthcare facilities, schools, and government offices. The company's business model is focused on securing long-term lease agreements to provide stability, resilience, and value to stakeholders. SBB's aggressive acquisition strategy during the first few years led it to become one of the leading real estate companies in the Nordic region (SBB, 2022a). Examples of acquired corporations are Offentliga Hus, Sveafastigheter, Hemfosa and Amasten (Fastighetsvärlden, n.d.). The company's primary approach was to acquire through sale and leaseback agreements with public and private sector tenants. SBB’s B and D shares have been listed on the Nasdaq Stockholm exchange since 2017 (SBB, 2022a). As of December 2021, SBB's B-share had reached its historical peak at 69.38 SEK (Avanza, n.d).

Since its establishment in 2016, SBB has experienced steady and successful growth, supported by long-term lease agreements and low-interest rates, which enabled cheap funding for executing its growth strategy. As of the end of 2022, SBB's rental properties had an average lease period of slightly above ten years, with its largest tenants being Learningsverkstadet, Trygge Barnehager AS, The Swedish State, Academedia, and The Norwegian State. Following the latest portfolio divestments, the company's portfolio decreased from SEK 149 billion to SEK 135 billion (SBB, 2022a).

Although SBB presented a profit after tax of negative SEK 9,822 million in 2022, its rental income has increased by 26%, from SEK 5,930 million in 2021 to SEK 7,447 million in 2022. Furthermore, SBB's cash flow from operations increased from SEK 2,459 million to SEK 3,485 million (SBB, 2022a).

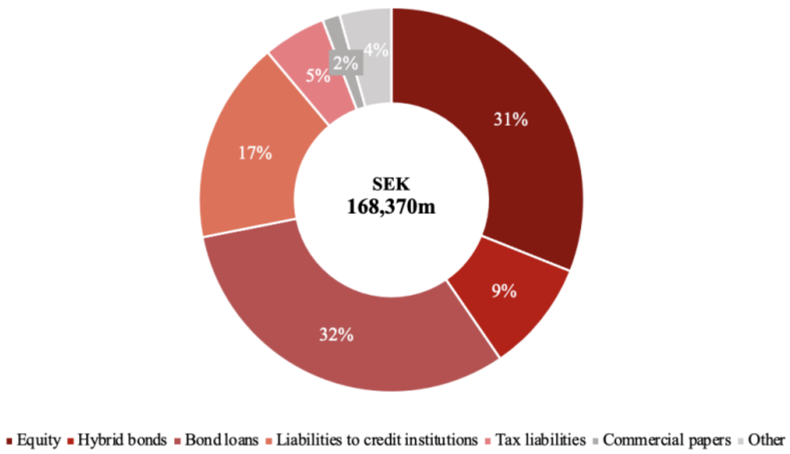
4.3.2 Capital structure

SBB has a financial strategy to maintain a low level of financial risk, diversify its capital structure, and establish a solid relationship with creditors to ensure easy access to capital and favourable refinancing alternatives. To achieve these goals, SBB has set specific financial targets, such as a loan-to-value ratio below 50%, minimum interest coverage of 3.0x, and a secured loan-to-value ratio of less than 30%. SBB’s annual statements communicate their ambitions to receive a rating of BBB+ in the short-term and A- in the long-term (SBB, 2022a).

In its Q1 interim report for 2023, SBB disclosed its LTV at 47%, with the secured LTV ratio being 18%. The company also reported an interest coverage ratio of 3.2x. At the end of the first quarter of 2023, SBB hybrid bonds amounted to 9% of total equity and liabilities (see Figure 2). SBB's interest-covered debt amounted to SEK 83,560mkr. Of this amount, SEK 28,480mkr was liabilities to credit institutions, representing 28.57% of total debt, while SEK 52,623mkr was in issued bonds, accounting for 52.79% of total debt. SBB aims to maintain a low level of interest on its outstanding debt and reported an average interest rate of 2.29% on its interest-bearing liabilities at the end of March 2023 (SBB, 2023).

Below, a breakdown of SBB's capital and debt maturity structure is presented.

Figure 2: Capital Structure Breakdown (hybrid bonds separated)



Source: SBB 2023

Table 2: Debt Maturity Structure, excl. commercial papers

Maturity	Nominal Amount, SEKm	Share, %
< 1 year	11,860	15
< 2 years	17,673	22
< 3 years	5,483	7
< 4 years	6,361	8
< 5 years	16,202	20
> 5 years	23,947	29

Source: SBB 2023

Table 3: Interest Payment Maturity Structure

Maturity	Nominal Amount, SEKm	Share, %
< 1 year	23,743	28
< 2 years	10,943	13
< 3 years	3,555	4
< 4 years	7,438	9
< 5 years	17,675	21
> 5 years	20,678	25

Source: SBB 2023

4.3.2.1 Hybrid bonds issued by SBB

Currently, the SBB has five outstanding hybrid bonds, consisting of three in EUR and two in SEK. One of the hybrid bonds in SEK was issued by Offentliga Hus, which was transferred to SBB upon SBB's acquisition of Offentliga Hus in 2021 (SBB, 2021b). The total outstanding amount is SEK 1,797m and EUR 1,350m. All hybrid bonds issued by SBB and the bond from Offentliga Hus have a first call date after 5.25 years, followed by an increase of 25 basis points in the interest rate after an additional five years. At the call date for all hybrid bonds, the effective maturity is less than 20 years, causing rating agencies to no longer regard them as equities. SBB's rated hybrid bonds received BB, BB, BB+ by S&P, Fitch & Scope at issuance (see Appendix 9.2 and 9.3). The interest rates on hybrid bonds vary, with those issued in EUR having a fixed rate and those issued in SEK having a floating rate (STIBOR 3m) plus a margin rate. Below is a summary of the bonds issued by SBB. The total quantity of the table's italicised hybrid bonds has been repurchased.

Table 4: SBB's Hybrid Bonds Summary in EUR

Issue Date	*April 2019*	January 2020	December 2020	June 2021
Issued Amount	*EUR 300m*	EUR 500m	EUR 500m	EUR 500m
Repurchased	*EUR 300m in 2021*	EUR 46m in	EUR 43m	EUR 61m
Tenor at issue	*Perpetual*	Perpetual	Perpetual	Perpetual
Effective maturity <20y	*At call date*	At call date	At call date	At call date
Rating Agency Equity Credit	*50% equity credit*	50% equity credit	50% equity credit	50% equity credit
Time to call date from issuance	*5.25 years*	5.25 years	5.25 years	5.6 years
Call Date	*26 July 2024*	30 April 2025	14 March 2026	20 January 2027
Coupon	*4.625%*	2.624%	2.625%	2.875%
Margin step-up	*Yes*	Yes	Yes	Yes
Interest deferral	*Yes, optional*	*Yes, optional*	Yes, optional	Yes, optional

Source: SBB, 2019b; SBB, 2020a; SBB, 2020b, SBB, 2021a

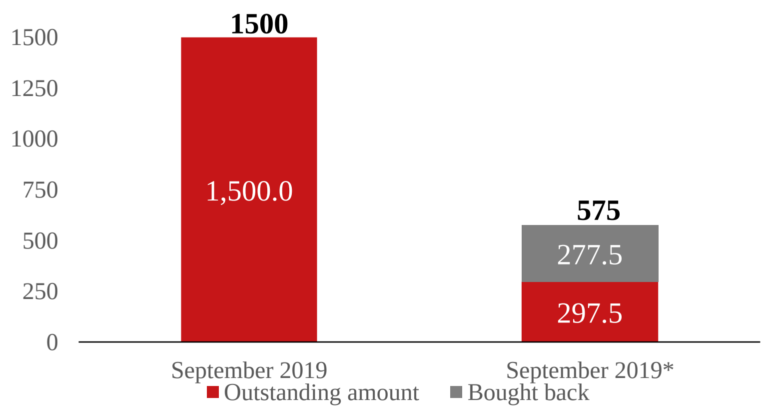
Table 5: SBB's Hybrid Bonds Summary in SEK

Issue Date	*September 2017*	*September 2018*	October 2019	October 2019*
Issued Amount	*SEK 1,000m*	*SEK 1,200m*	SEK 1,500m	SEK 575m
Repurchased	*SEK 300m 2018 SEK 700m 2019*	*SEK 1,200m 2019*	SEK 0	SEK 278m
Tenor at issue	*Perpetual*	*Perpetual*	Perpetual	Perpetual
Enters effective maturity <20y	*At call date*	*At call date*	At call date	At call date
Rating Agency Equity Credit	*50% equity credit*	*50% equity credit*	50% equity credit	50% equity credit
Time to call date from issuance	*5.5*	*5.5*	5.25	5.25
Call Date	*2023*	*30 March 2024*	28 January 2025	7 January 2025
Coupon	*3m STIBOR + 700 bps*	*3m STIBOR + 635 bps*	3m STIBOR + 350 bps	3m STIBOR + 685 bps
Coupon step-up	*Yes*	*Yes*	Yes	Yes
Optional Interest Deferral	*Yes, optional*	*Yes, optional*	Yes, optional	Yes, optional

**Issued by Offentliga Hus*

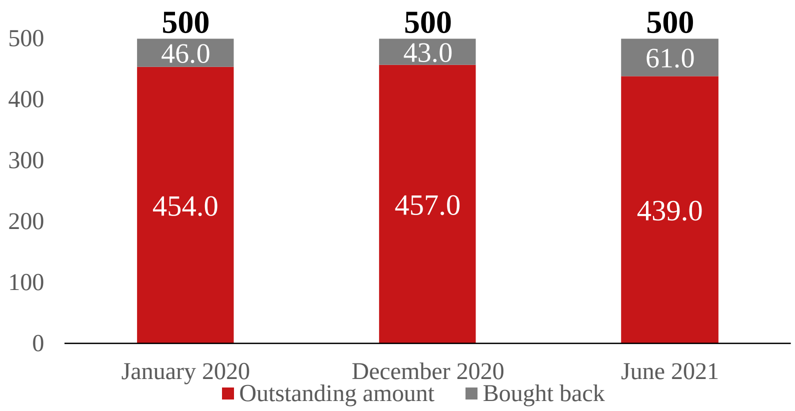
Source: SBB, 2017a; SBB, 2018a; SBB, 2019a; Offentliga hus, 2019

Figure 3: SBB's outstanding Hybrid Bonds, incl. buybacks, SEKm



Source: SBB, 2022a

Figure 4: SBB's outstanding Hybrid Bonds, incl. buybacks, EURm



Source: SBB, 2022a

4.4 Credit Rating

In 2017, SBB received its first credit rating of BB with stable outlooks from S&P. As of today, SBB receives credit ratings from three different rating agencies, Fitch Ratings ("Fitch"), Scope Ratings ("Scope"), and S&P Global Ratings ("S&P"). Fitch has covered SBB since 2018, Scope started to cover SBB in 2021, and S&P assigned their first rating in 2017.

Table 6: Credit Institutions Rating Scales

Fitch Rating	Scope	S&P	
AAA	AAA	AAA	Investment Grade
AA+, AA, AA-	AA+, AA, AA-	AA+, AA, AA-	
A+, A, A-	A+, A, A-	A+, A, A-	
BBB+, BBB, BBB-	BBB+, BBB, BBB-	BBB+, BBB, BBB-	
BB+, BB, BB-	BB+, BB, BB-	BB+, BB, BB-	High Yield
B+, B, B-	B+, B, B-	B+, B, B-	
CCC	CCC+, CCC, CCC-	CCC+, CCC, CCC-	
CC	CC	CC	
C	C	C	

Sources: Fitch Ratings, Scope Ratings, and S&P

4.4.1 Rating Institutions' Evaluation of Corporate Hybrid Bonds

One of the essential facets of the financial system is managing and being aware of operational and financial risks. For retail and institutional investors, one must consider the company's ability to meet its obligations. Credit rating agencies assist investors as it could be challenging, difficult to comprehend, and time-consuming to analyse a company's financial situation and risk independently. Credit rating agencies assign ratings to various issued capital, including corporate hybrid instruments and bonds, government bonds and sovereign capital (CFI, 2022).

In this section, we comment briefly on Fitch Rating, Standard & Poor's, and Scope Rating, which all provide SBB with a credit rating (SBB, 2022b). In 2018, SBB chose to discontinue its business relationship with Moody, citing its reliance on other rating agencies as sufficient to meet its financial and operational objectives (SBB, 2018b). We will briefly outline the three rating institutions' methodology for assigning equity components to hybrid bonds issued by corporations. Hybrid bonds can receive equity content of 0% or 50% from credit rating institutions.

4.4.1.1 S&P

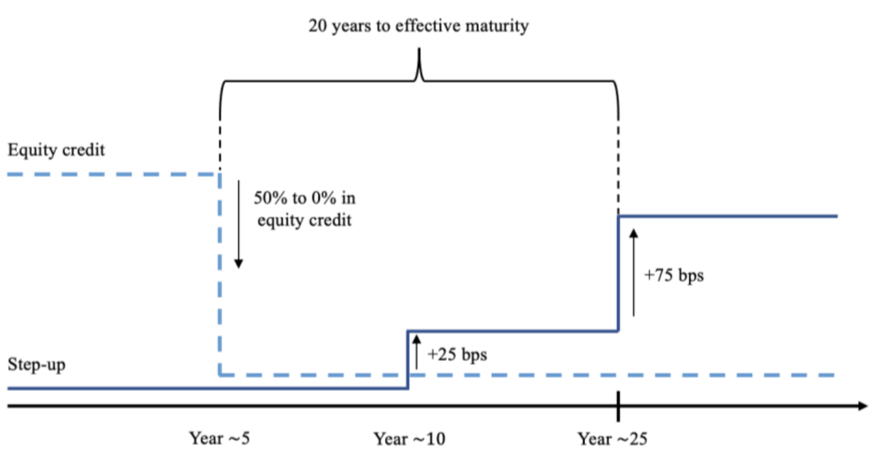
To receive equity treatment on the issued hybrid bond, the instrument must be available and able to absorb losses or conserve cash in stress scenarios before the point of nonviability or bankruptcy, whichever comes first. This should persist for a minimum of five years without precipitating a default or liquidation of the issuer. In addition, the instrument should be devoid of terms or features that discourage or materially delay deferrals, such as an, e.g. higher rate on accrued deferred amounts. The hybrid should not be callable within the first five years after issuance and needs to have a maturity date longer than 20 years (with an issue rating of BBB- or higher), 15 years (BB) or 10 years (B or lower), to receive intermediate equity content (S&P, 2022).

When designating equity content, S&P (2022) places a great deal of emphasis on the intention behind the issuance of the instrument. Each instrument will be evaluated separately before being assigned equity, debt, or a mix of equity and debt proportions. When it comes to the redemption of the equity instrument, S&P (2022) typically consider redemptions of up to 10% of outstanding hybrids over twelve months and 25% over ten years to be insignificant; therefore, they do not require replacement. This should, therefore, not affect the creditworthiness and rating of the company. Furthermore, hybrid instruments that meet the criteria for achieving equity credit may account for a maximum of 15% of an issuer's capitalization. If the hybrid capital instruments surpass 15% of the capitalization (and it is expected to persist), any amount exceeding the threshold is not assigned equity content (S&P, 2008).

If a hybrid bond is called without being replaced by another hybrid or the issuance of new common equity, S&P (2022) would be inclined to allocate zero equity content to the remaining and future hybrids, as the issuer's actions would likely alter the perception of their intentions towards hybrid capital. The absence of equity content would result in the hybrids being treated entirely as debt in their financial measurements.

If a corporation decides not to call a hybrid bond, it could lose equity treatment on that particular bond, but it retains equity treatment on the other bonds. However, this must be assessed on a case-by-case basis as there is no general rule. The reason is that the effective maturity will be less than 20 years (even if the term, according to the contract, is perpetual). This is because the second step-up is often more than 25bps when the hybrid can be redeemed, which means that the interest rate will be higher, and, therefore, a financial incentive exists to call it. It is, therefore, not the first call date that causes the hybrid to lose equity content, but the effective maturity is less than 20 years (S&P, 2008).

Figure 5: Equity credit and effective maturity



Source: S&P, 2008; Authors

Table 7: SBB's Historical Rating from S&P

S&P	2017	2018	2019	2020	2021	2022
Rating	BB	BB	BBB-	BBB-	BBB-	BBB-
Outlook	Stable	Positive	Positive	Positive	Positive	Negative

Source: SBB, 2017b; SBB, 2018b; SBB, 2019c; SBB, 2020c; SBB, 2021b; SBB, 2022a

4.4.2.1 Fitch Rating

Fitch (2020) states that equity credit is an analytical concept explaining to which degree they view a specific security to have debt- or equity-like qualities. Equity credit assigned to an instrument can vary from 0%, 50%, or 100%. Fitch assigns equity to hybrid bonds if no default or acceleration event could result in a general corporate default or cross-default that would spread to more senior corporate obligations. The hybrid bond should be subordinated to all senior debt holders, as well as secured and unsecured bonds, and will therefore have high loss absorption. The instrument should have no (or very long) maturity, no put right for the investor, or other features that would require principal repayment for the issuer within five years. The first call should be no less than five years from the date of issuance. Furthermore, it is only considered a call date if it is accompanied by a coupon step-up greater than 1%. To maintain the assigned equity credit, it is necessary to replace a hybrid bond with a debt instrument of equivalent maturity and subordination characteristics upon its call.

Fitch's decision to allocate a portion of an issuer's hybrid to equity or debt is not influenced by accounting rules or the instrument's classification in the issuer's financial statements. Instruments reported on an issuer's balance sheet as debt or equity will be reallocated from that category and classified as entire debt, entirely equity, or 50% debt and 50% equity for Fitch's ratio analysis. In its fundamental analysis of an issuer, Fitch uses the resulting adjusted leverage ratios.

Table 8: **SBB's Historical Rating from Fitch**

Fitch Rating	**2018**	**2019**	**2020**	**2021**	**2022**
Rating	BB	BBB-	BBB-	BBB-	BBB-
Outlook	Positive	Stable	Positive	Positive	Positive

Source: SBB, 2018b; SBB, 2019c; SBB, 2020c; SBB, 2021b; SBB, 2022a

4.4.3.1 Scope

Scope has several criteria for evaluating the equity credit of hybrid instruments. These are divided into 50% and 0% equity for hybrid bonds; if no measures are met, the instrument will be treated entirely as debt. The rating agency also considers the proportion of equity credit and adjusts the interest paid. Worth mentioning is that decisions can vary from the scale grounded on Scope's judgment (Scope, 2022). According to Scope (2022), to receive an equity credit of 50%, the hybrid bond coupons must be deferrable and cumulative. Regarding subordination, all current and future debt instruments must rank senior the hybrid bonds; only equity instruments can be junior. As a result, these hybrid instruments serve as a loss-absorbing buffer for more senior debt, which might be advantageous for the issuances of high-yield issuers when conducting a recovery analysis.

A maturity of at least 20 years is a criterion for 50% equity credit. If a hybrid bond is called, to keep the assigned equity credit, a replacement with a debt instrument with the same maturity and subordination characteristics is mandatory. The rating agency wants to see a certain guarantee in the permanency features of the capital structure, which motivates this replacement need. Hybrid bonds have very long maturities (often perpetual) but have call options and step-ups that incentivise the issuer to call the bond. This might undermine the permanency attributes suggested by its long maturity (Scope, 2020).

Table 9: **SBB's Historical Rating from Scope**

Scope	**2021**	**2022**
Rating	BBB	BBB
Outlook	Stable	Stable

Source: SBB, 2021b; SBB, 2022a

5. The case

5.1 SBB’s growth strategy and divestments

Since the company's founding, the desire for growth has been one of the primary pillars of its strategy to become one of the largest public real estate companies in the Nordic. Beginning in the first full year of operations in 2017, with a portfolio of residential and commercial buildings worth SEK 23b, SBB has since acquired and formed joint ventures to increase the portfolio to over SEK 135,6b by 2022 (SBB, 2022a).

Figure 6: Development of SBB property value (market value) in SEK, 2017-2022

Source: SBB, n.d.

During these years, Ilija Batljan and management have made a remarkable growth journey and strengthened the company’s credit rating. The improvement in credit rating has been the key for SBB to achieve growth. The combination of wanting to achieve high inorganic growth while improving its credit rating has been important for the company, and it has, over the years, succeeded with this strategy (Johansson, 05.04.2023).

Despite SBB's cash flow from long lease contracts with secure tenants, such as state-owned organizations, the growth strategy required external capital to be successful. In 2017, global interest rates were at an all-time low, resulting in cheap capital from financial institutions. Furthermore, in low-interest environments, institutional and retail investors seek higher yields on both the stock and bond markets (Interviewee 2, 11.04.2023).

Like other Swedish real estate companies, SBB face challenges due to the shift in the macroeconomic climate, putting a pause on the company's growth through acquisitions. The company had large amounts of outstanding bonds and liabilities maturing in 2022 and 2023 and needs to strengthen its cash position to meet these obligations (Fastighetstidningen, 2022). For example, in November 2022, SBB sold 49% (SEK 9.2b) of its social infrastructure portfolio to a newly founded subsidiary of SBB Educo AB. The buyer was one of the world's largest infrastructure companies Brookfield (SBB, 2022b). Furthermore, in late December 2022, SBB sold 49% of its holdings in Heba to a newly founded subsidiary, with Industribolaget as a part-owner. Batljan explained in an interview with Fastighetsnytt (2022) that this transaction was part of the company's strategy to reduce its exposure to associated companies. The transaction provided SBB with SEK 680 million.

5.2 Entering the Swedish and European bond market

SBB has, since the start, turned to the bond market for financing. The decision to turn to the bond market is due to the lower financing costs compared to secured bank debt. "*Since the start, access to the bond market has been prioritized for cheap, unsecured financing. This has been crucial to succeed with their growth strategy.*" (Interviewee 1, 03.04.2023). With a low repo rate of around zero percent and quantitative easing programs purchasing government and corporate bonds, the conditions have been favourable, offering cheap financing and liquid markets (Riksbanken, 2020). In May 2022, The Riksbank implemented a first interest rate increase, raising it from zero to 0.25 percent. Since then, there have been five subsequent increases, resulting in the current policy rate of 3.5 percent as of May 2023 (Riksbanken, 2023).

A risk with SBB relying much on the bond market is that it might have limited their ability to create strong relationships with the Swedish banks. "*When bank financing is later needed, it is hard to go and knock on the bank's doors and get good terms.*" (Interviewee 1, 03.04 2023). A more stable option could have been to diversify the capital base more. "*It might have been better with more bank capital at the bottom when they started their growth journey. Create a stable base with bank debt at the bottom, then top it up with hybrid instruments and bonds.*" (Interviewee 1, 03.04 2023). Furthermore, Hallberg (05.04.2023) states that the Swedish banking system is a relationship business with only four large banks available (SEB, Nordea, Swedbank and Handelsbanken, and maybe Danske Bank). Hallberg (05.04.2023) continues that SBB has not, despite the comprehensive bond issuance, left the banking system ultimately and still holds relationships with the banks. Although SBB has not relied entirely on bank debt to finance its growth, it has maintained a good relationship with financial institutions, which have played a significant role in facilitating the issuance of bonds to the market (Lindahl, 20.04.2023).

Although some analysts might believe that a more bank debt-heavy balance sheet had been suitable, SBB's Lindahl (20.04.2023) explains that traditional banking institutions have not been capable of issuing the debt levels required for SBB's fast growth. The banks have shown little interest in these high amounts of funding. As a result, the bond market has played a crucial role in facilitating the company's growth journey. The need for SBB to secure financing for its ambitious growth led to SBB being left with little choice but to explore alternative funding sources, such as the bond market. The bond market has offered the necessary financial support for the company's expansion and further broadened the investor base. Regarding the maturity profile for the real estate sector, five to six years is considered a relatively long financing maturity (Interviewee 2, 11.04.2023).

In deciding which market to issue bonds, the company must consider that the Swedish bond market offer smaller issuing sizes and is not as liquid as the Euro bond market (Johansson, 05.04.2023). Hallberg (05.04.2023) states that *"Sweden has a smaller and less liquid market of corporate bonds, where real estate comprises the majority of bonds issued. In addition, the bonds' duration typically ranges from 3-5 years. If a corporation wants to issue larger amounts and/or with longer duration, they need to go to Europe for issuance. In this way, they might not need to issue new shares."*, implying that SBB would have needed to consider other funding options if not entering the European bond market.

In line with this, to access an even larger investor base and funding, SBB also turned to the Euro market when issuing traditional and hybrid bonds. The Euro bond market enabled the firm to issue a greater quantity of bonds, owing to the greater size and liquidity. In addition, reaching the Euro market broadens the investor base even more, creating more flexibility and available options (Dimming, 20.04.2023). Johansson (05.04.2023) highlights that a benchmark bond has a value of EUR 500 million and that it is doubtful for a corporation to issue bonds of such a high volume in a single issuance in the SEK market. Gustavsson (11.04.2023) emphasized that Euro-denominated bonds entail a higher level of refinancing risk due to their significant size. Subsequently, the large issuances of hybrid bonds can pose difficulties in challenging market conditions. In such circumstances, the issuance and refinancing of hybrid bonds can become complicated. To maintain the balance between equity and debt levels in their financial statements, businesses may need to issue substantial amounts of new equity.

5.3 Credit rating

5.3.1 Focus on credit rating

Gustavsson (11.04.2023) underscores the importance of credit ratings to the successful operations of SBB. The company's financial strategy focuses on obtaining a favourable rating that allows it to access funds at the lowest possible cost. Consequently, SBB's ability to uphold a strong rating enables ongoing growth and expansion and secures its position within the competitive market. In light of these conditions, pursuing a favourable credit rating assumes almost existential importance for SBB, needing close attention and diligent efforts from all parties engaged in the company's financial operations. When asked about what SBB takes into consideration when optimizing its capital structure, Lindahl (20.04.2023) expressed that it is very credit rating driven. When SBB decided to utilize both the Swedish and European bond markets to acquire capital to reach new investors and obtain necessary low-cost funding for their growth journey, the need for a high credit rating became even more pressing (Interviewee 1, 03.04 2023). Even though the European market's reliance on credit ratings is not as pronounced as that of, for example, the U.S., an investment grade rating is still seen as crucial by many investors as evidence of financial stability. It is, therefore, necessary to reach investors by being an investment-graded company (Hallberg, 05.04.2023).

Hallberg (05.04.2023) noted that some issuers might perceive the need for ratings to be more significant for foreign investors. This can be attributed to the fact that foreign investors may not have the same level of familiarity with the issuer as domestic investors. Similarly, Interviewee 2 (11.04.2023) discusses that foreign investors may also not be familiar with the Swedish real estate market and regulations, so an investment grade rating might have a substantial signalling value. As a result, ratings provide a means for foreign investors to evaluate the issuer's creditworthiness, thereby enhancing the issuer's ability to attract foreign capital. In the case of SBB, a large and well-known issuer in the Swedish capital markets, the Swedish investor community may not be as concerned and reliant on credit ratings as investors in the Euro bond market.

Gustavsson (11.04.2023) and Interviewee 1 (03.04.2023) both state the force-selling effect of a possible downgrade to high yield will be more significant in the European market than in the Swedish market since investors do not possess mandates to the same extent. The forced selling could also spill over into other sectors of the European bond market, leading to a contagion effect.

Hybrid bonds have the potential to receive 50% equity treatment from credit rating institutions, which can be beneficial for the issuer's credit rating. However, for the issued hybrid bonds to contribute positively to SBB's credit rating, the criteria established by the rating institutions (see section 4.5) must be met, making it essential for SBB to adhere to all relevant metrics (Gustavsson, 11.04.2023). For SBB, at times of issuance, hybrid bonds were a suitable instrument to issue because of the credit rating institutions' equity treatment of the instruments. According to all interviews, the most significant factor driving SBB's decision to issue hybrid bonds is its beneficial treatment from credit rating institutions (e.g., Interviewee 1, 03.04.2023; Johansson, 05.04.2023; Gustavsson, 11.04.2023). From credit rating institutions' perspective, hybrid bonds can strengthen a company's rating because they can positively impact financial metrics if they are counted as, for example, 50% debt (i.e., lower debt burden compared to the same amount in "regular" bonds). On the other hand, if a hybrid bond has 100% debt treatment, it generally does not have a positive effect, rather the opposite since the instrument comes with high-interest rates and complexity. While diversifying funding sources, such as not relying solely on bank loans, is advantageous, the complexity of hybrid bonds can be seen as a disadvantage by credit rating institutions, resulting in an overall neutral effect on the balance sheet (Interviewee 2, 11.04.2023).

Worth noting is that hybrid bonds come with a higher cost than a more standard debt instrument, even before their first step-up. Forsberg (03.04.2023) explains that corporate entities might benefit from issuing higher-priced instruments, such as hybrid bonds, since these instruments can lead to an overall higher rating for the corporation, allowing firms to negotiate more favourable terms and conditions with financial institutions and markets. Lindahl (20.04.2023) states that the real estate sector has used the instrument from a credit rating perspective during the last five years, "*But in general, among all real estate companies that have issued hybrid bonds, it has been one, perhaps not the largest, but an important driver anyway.*" (Lindahl, 20.04.2023). SBB, in Q1 2023, had 9% of its total capitalization in hybrid bonds (see Figure 2), therefore not surpassing the threshold of 15% where the exceeding amounts are not assigned equity content (S&P, 2008).

5.3.2 Receiving first investment grade rating

On 8 April 2019, SBB made its first announcement to issue a EUR 300m hybrid bond in the Euro bond market (SBB, 2019k). CEO Batljan acknowledged the transaction as a significant milestone toward achieving a BBB rating, eagerly anticipating future credit reports from rating agencies (Fastighetsnytt, 2019). On 8 April 2019, the same day as the EUR 300m hybrid bond announcement, it was published that SBB was put on watch (positive outlook) by the two rating institutions S&P and Fitch and that the credit rating institutions expect the firm to be investment grade after the issuance of the hybrid bonds (SBB, 2019l; SBB, 2019m). On 16 April 2019, SBB received its first investment grade rating, BBB- with a stable outlook from Fitch (SBB, 2019n). The press release included a statement from the CEO, Ilija Batljan: "*We are proud to deliver on our targets and receive an investment grade rating. We will continue to focus on redeeming existing secured indebtedness and new investments in social infrastructure, such as elderly care homes, group housing and schools and rent-regulated residentials with the target to achieve and maintain a BBB rating.*" (SBB, 2019n). It was reported that SBB had successfully issued the hybrid bond in the European debt capital market on the same day Fitch assigned their new credit rating. The issuance of bonds was oversubscribed, exceeding the issued amount by over two times, and was scheduled to be issued on 26 April 2019 on Euronext Dublin. The funds raised through the issuance of hybrid bonds were declared to be directed toward general corporate purposes, primarily for the redemption of existing secured debts (SBB, 2019p). On the same day as the issuance, 26 April 2019, S&P assigned an investment grade rating, BBB- with a stable outlook to SBB (SBB, 2019q).

5.4 Accounting IFRS and differences

According to IFRS, hybrid bonds can be treated as 100% equity on the balance sheets of corporations, thereby enhancing the appearance of financial stability. As repeatedly stated in SBB's annual reports, the firm's hybrid bonds are classified as an equity instrument, not a liability. The interest on these instruments is reported directly against equity (e.g., SBB, 2021b; SBB, 2022a).

Modern hybrid bonds have emerged as an "*invention*" in the real estate sector, pointed out by Interviewee 2 (11.04.2023). This is since the real estate industry, having built up a lot of debt and being capital intensive, is willing to work with the debt component in the capital structures to improve and "*tidy up*" key ratios (Interviewee 2, 11.04.2023). Dimming

(20.04.2023) also states that hybrid bonds, classified as equity under IFRS, were an advantageous way to bring in equity. Generally, hybrid bonds are a cheaper financing alternative than, e.g. common equity (Interviewee 2, 11.05.2023). Analysts further suggest that the accounting treatment for hybrid bonds is the second most significant reason for SBB to issue them (e.g., Johansson, 05.04.2023). As per Gustavsson's (11.04.2023) statement, hybrid bonds are a "*double positive*" instrument since they possess two favourable attributes. Firstly, as mentioned, they are classified as equity by IFRS, and secondly, the coupons are tax-deductible. This is similar to interest payments on regular bank loans but unlike dividend payments to holders of common shares. It is highlighted that this characteristic is a crucial reason for the increasing popularity of hybrid bonds among corporations that do not have credit ratings. Noteworthy is that despite IFRS granting hybrid bonds full equity treatment, many professionals covering SBB adjust the key ratios by treating hybrid bonds fully as debt rather than equity, as noted by Johansson (05.04.2023), Interviewee 2 (11.04.2023), and Hallberg (05.04.2023).

Interestingly, Interviewee 1 (03.04.2023) highlights that some corporations adopt a more transparent approach to accounting for hybrid bonds on their balance sheets, thereby facilitating better comprehension for non-professionals that this instrument is not strictly equivalent to ordinary equity. In addition, Interviewee 2 (11.04.2023) has stated that SBB's equity ratio is, naturally, higher when it includes the use of hybrid bonds compared to when it doesn't. *"This could lead to a potential issue, as private investors may not have the same understanding of hybrid bonds as professionals"* (Interviewee 2, 11.04.2023). This discrepancy in knowledge could potentially cause confusion or misinterpretation among private investors. As hybrid bonds are senior to common stockholders, their precedence can directly impact stockholders in case of liquidation or default, subordinating common stockholders to hybrid bondholders.

5.5 Problems arising

Historically, in a low-interest rate environment, SBB and other issuers of hybrid bonds could easily roll over their outstanding hybrid bonds by calling the bond at the first call date and issuing a new one with the same equity content. This ensures that the equity-leverage ratio remains stable and credit rating institutions will not change the equity treatment for the instrument. By utilizing this strategy, SBB can retain the equity content of its outstanding hybrid bonds. However, as interest rates increase and call dates approach (see Appendix 9.1), the situation for all hybrid bond issuers becomes more critical (Gustavsson, 11.04.2023). Johansson (05.04.2023) highlights a shift in the approach to the Swedish real estate sector's hybrid bonds. With the financial instrument being a relatively recent addition to the real estate sector, it was initially anticipated that all issued hybrid bonds would be called at their first call date. However, the present scenario is vastly different, marking a significant shift from these earlier expectations.

According to Johansson (05.04.2023), it is evident today that a new bond issuance would have incurred substantially higher costs than in previous years, irrespective of whether SBB holds its credit rating. Hypothetically, to roll over SBB's debt portfolio in these present conditions would pose a challenge, owing not only to the increase in the underlying interest rates but also to an increase in SBB's credit spreads. If the company were to roll over its entire debt portfolio, the financing costs would be considerably higher compared to, e.g., 2021.

A crucial hurdle for SBB going forward could be the future challenges it may encounter in issuing new hybrid bonds. This is linked to the hybrid bonds nearing their first call date, which has given rise to market speculation about whether or not they will be called and replaced. SBB's first call date is set to occur in 1.5 years; however, it is currently premature to predict the future trajectory of interest rates in 2024 (Interviewee 1, 03.04.2023). Suppose the market situation on the call date is what the corporation is experiencing today. In that case, SBB may face difficulties rolling over its hybrid bonds in the market. Several news sources state that the bond market in Sweden is closed (Dagens Industri, 2022; Svenska Dagbladet, 2022), while several interviewees (e.g., Interviewee 2, 11.04.2023; Gustavsson, 11.05.2023) suggest that this is an incorrect term to use, as it is just the pricing that has shifted. Corporations that are actively engaged and have a significant presence in the bond market continue to raise capital, although with some limitations. However, for high-yield corporations, the bond market may be deemed inaccessible or "closed" due to the high costs associated with issuing bonds.

From the investor's point of view, reduced liquidity in the bond market can pose challenges for them seeking to buy or sell bonds at their preferred price. These circumstances could result in wider bid-ask spreads for SBB-issued instruments, which may escalate the trading costs. Furthermore, the contraction of liquidity can heighten the likelihood of price volatility since even minor transactions could trigger significant price fluctuations. A reduction in liquidity may also amplify the counterparty risk since investors may confront complications in locating suitable buyers or sellers for their bonds. This potential outcome may be particularly concerning during periods of market stress, where investors may require the sale of bonds to generate cash (Interviewee 2, 11.04.2023).

The most significant risk that SBB may face with its hybrid bonds in an environment with rising interest rates and an illiquid bond market is the bonds issued in EUR due to their size. The large outstanding amounts could make it challenging to refinance them. According to, for example, S&P's methodology, there is a risk that all hybrid bonds lose their equity rating if one instrument is called and not replaced. Losing all equity content on the hybrid bonds could lead to SBB being downgraded to a lower credit rating (Gustavsson, 11.04.2023). Although it may be challenging to call hybrid bonds on their first call date, there is another strong incentive to call them due to market conventions and expectations; keeping a good relationship with the market is crucial, particularly in Sweden (Forsberg, 03.04.2023).

5.6 Actions taken by SBB

5.6.1 Repurchase and issuance of hybrid bonds in 2019

SBB has strategically moved to repurchase portions of its hybrid bonds, both full and partial. The repurchases are a component of the company's broader liability management strategy, which aims to optimize its capital structure and lower its financing costs (SBB, 2022a).

On 16 October 2019, SBB made a tender issue to the holders of their hybrid bonds issued in September 2017 and September 2018, see Tables 10 and 11. Connecting with the tender offer, SBB disclosed its plans to issue a new hybrid bond denominated in SEK, subject to the prevailing market conditions at the time. In the same press release, it was stated that the repurchase of the outstanding two instruments where conditional upon a successful issue of the new hybrid bond (SBB, 2019d).

The hybrid bond issuance was successful and had a settlement date of 28 October 2019, and the tender offer went through. SBB also made additional purchases in the market, lowering the outstanding amount further (SBB, 2019f). Shortly after, on 28 October 2019, SBB made a new tender offer with lower prices for the two securities. SBB now had acquired more than 80% of the issued amount of each security and intended to exercise their right to redeem the outstanding capital securities in mid-December. The redemption would be made at 100% of the principal amount, which was noted to be significantly lower than the second tender offer made (SBB, 2019f). An overview of the tendered offers can be seen in the tables below.

Table 10: Capital Security issued in September 2017

Tender Offer Date	16-10-2019	28-10-2019
Outstanding Amount, SEKm	700	15*
Price, %	113,40%	113,33%
Tender Offer Accepted, SEKm	571	8
Remaining Outstanding Amount, SEKm	129	5

After additional redemptions on the market

Source: SBB, 2019d; SBB, 2019e; SBB, 2019f; SBB, 2019g

Table 11: Capital Security issued in September 2018

Tender Offer Date	16-10-2019	28-10-2019
Outstanding Amount, SEKm	1200	100*
Price, %	112,80%	112,73%
Tender Offer Accepted, SEKm	894	62
Remaining Outstanding Amount, SEKm	306	36

After additional redemptions on the market

Source: SBB, 2019d; SBB, 2019e; SBB, 2019f; SBB, 2019g

On 7 November 2019, SBB announced that it had cancelled all the repurchased capital securities, amounting to SEK 995m for the September 2017 security and SEK 1,164m for the September 2018 security (SBB, 2019h). Cancellation of repurchased bonds means that the cancelled amount cannot be reissued or sold in the future by the issuer (SBB, 2017a; SBB, 2018a). SBB cancelled the repurchased bonds to exercise its right to redemption. The redemption took place on 19 December 2019, and the redemption amount was distributed to each individual listed as the owner in the debt register maintained by Euroclear Sweden on 19 December 2019 (SBB, 2019i; SBB, 2019j).

Dimming (20.04.2023) states that these buybacks have been due to favourable market conditions and, thereof, a part of the financial liability management to enhance shareholder value. The September 2017 security had a rate of STIBOR 3M plus 700 bps, and the September 2018 security had a rate of STIBOR 3M + 635 bps. In October 2019, the new hybrid bond was issued with a rate of STIBOR + 350 bps (see Table 5).

6.5.2 New market conditions

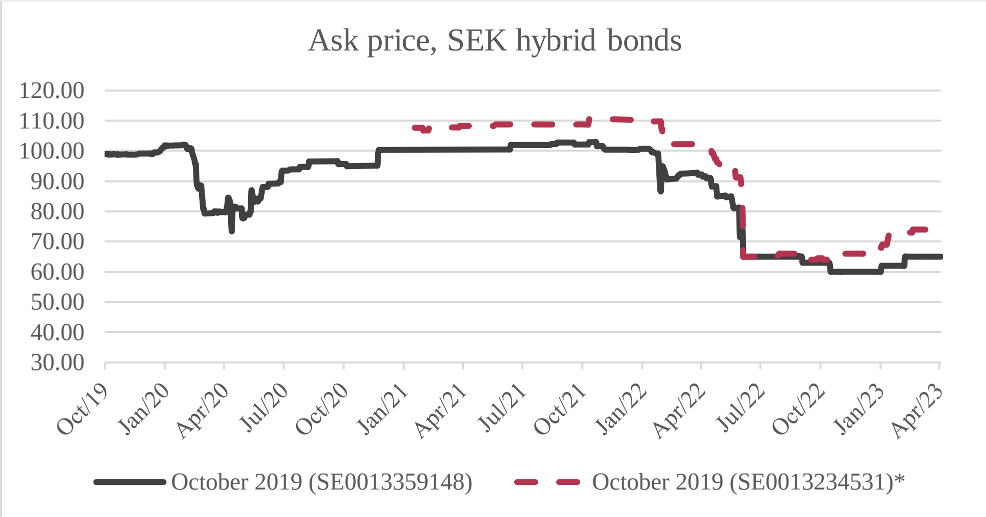
The Riksbank indicated in November 2021 that the repo rate would be raised in the latter part of 2024 (Riksbanken, 2021). "*Although some observers anticipated that interest rates would* *begin to rise, there were only a few who believed that this could happen earlier than what the Riksbank stated*." (Interviewee 2, 11.04.2023). However, the developments during the last 1.5 years exceeded expectations. Looking back to the period spanning from 2020 through 2021, as well as to 2019, many financial projections did not factor in the possibility of a much higher repo rate, and hybrid debt issued in 2018-2019 probably did not carry high-interest rates. Issuers of hybrid bonds with floating rates in, e.g. 2018, with the first call date in 2023, likely did not anticipate the instruments carrying such a significant rate of interest getting closer to the call date (Interviewee 2, 11.04.2023). As a result, some corporations have begun repurchasing outstanding amounts of their hybrid bonds (Forsberg, 03.04.2023). This is a positive move towards reducing refinancing risk (Interviewee 1, 03.04.2023).

Johansson (05.04.2023) and Gustavsson (11.04.2023) underline that SBB's hybrid bonds have been trading at around 35-40% of face value. Johansson (05.04.2023) further explains that many hybrid bonds now are priced to worst due to market expectations that they are not going to be called on the first call date.

Figure 7: SBB's outstanding hybrid bonds (EUR issuance) ask price development

Source: Eikon, 2023

Figure 8: SBB's outstanding hybrid bonds (SEK issuance) ask price development



**Issued by Offentliga hus*

Source: Eikon, 2023

Johansson (05.04.2023) expressed a highly positive view of SBB's decision to repurchase hybrid bonds. It is worth noting, however, that corporations face a limitation in their capacity to repurchase hybrid bonds due to the constraints imposed by credit rating assessments, which allow for a maximum buyback of 10% per annum. Despite this limitation, the company has generated substantial value for its common shareholders by repurchasing at discounted rates. In 2022, SBB repurchased hybrid bonds with a book value of SEK 1,532m. These were repurchased at a discount and generated a profit of SEK 805m before tax that is recognized in equity (SBB, 2022a). The following statement encapsulates Johansson's (05.04.2023) enthusiastic endorsement of this strategy, "*I think that's perhaps one of the best opportunities you have in the market today.*" Furthermore, emphasis is put on the considerable advantage of purchasing hybrid bonds in the secondary market at a discount. "*To be able to buy back in the secondary market at 35-40% of face value, then you just congratulate*!" (Johansson, 05.04.2023).

Gustavsson (11.04.2023) signifies that repurchasing bonds can be seen through two perspectives, depending on whether you analyse the firm as a whole or the position of individual investors. From a firm stand, repurchases are positive because SBB works with its capital structure. If a company can repurchase its debt at a discounted price, such as, e.g. 40% of its face value, this can positively impact its debt obligations and equity position. By retiring debt at a discount, the company reduces its debt burden while simultaneously realizing a financial gain, which is recorded as a financial income on the income statement. This results in an increase in the company's net income and equity position. *"Companies, such as SBB, that have successfully acquired debt at favourable prices have benefitted greatly from this strategy."* (Gustavsson, 11.04.2023). From an investor perspective holding more senior bonds, the repurchases of hybrid bonds can be questionable. The repurchase of the subordinated hybrid bonds creates a worse position for the more senior bondholders. This perspective is interesting in comparison with Johansson (05.04.2023), who highlighted that the subordinated stockholders benefitted from the repurchase.

Furthermore, Interviewee 1 (03.04.2023) states that while investors of the hybrid bonds may be dissatisfied that they did not receive the expected yield, corporations continue to contribute liquidity to their instruments, giving investors the possibility to sell. This is especially important in turbulent times when selling might be difficult.

5.7 The first call date

The call dates for hybrid bonds within the Swedish real estate sector are approaching (see Appendix 9.2). The situation also applies to SBB, who have five call dates between January 2025 and January 2027, and the total amounts being called are EUR 1,350m and SEK 1,797m. Worth noting is that these outstanding amounts may decrease before the call dates if SBB persists with buybacks as part of its liability management strategy. When the first call date arrives, several options are available for an issuer.

According to SEB (2022), one option is to replace the hybrid bond with a new one. If a hybrid bond is called and replaced with a new bond structured following the guidelines of credit rating institutions, the equity treatment of the bond will remain unchanged. This action will, therefore, have no impact on the firm's credit ratings (Fitch, 2020; S&P, 2022; Scope, 2020). However, the financing cost for this option would likely increase at current yield levels, as previously discussed by, e.g. Johansson (05.04.2023) and Gustavsson (11.04.2023). Gustavsson (11.05.2023) and Hallberg (05.04.2023) state that, as of today, issuing hybrids is costly due to the coupon, and it will take some time until it becomes cheap again. There is little interest from the investor community at this stage, making it unclear whether the hybrid market will be available. According to Johansson's (05.04.2023) assertion, there is no demand for hybrids in the market within the current environment. Nevertheless, in the next 2-3 years, when numerous companies determine their call decisions, it is speculated that a new hybrid instrument may only exhibit an increase of 100 to 200 basis points. In such a scenario, the corporation may call the existing hybrid and issue a new one as goodwill for investors. Further, Johansson (05.04.2023) states that it is possible that the investor community's interest will come back later and that it is risky to say that the investor will never be interested in hybrid bonds again. But what can be seen today is that there is very little interest from the investor collective for hybrid bonds, and simultaneously there is no rationale for firms to issue hybrid bonds because of the high costs.

Secondly, another potential option is to replace the hybrid with new common equity or similar instruments, such as preference or D-shares. In this scenario, the current equity treatment would remain in place if the outstanding amount of hybrid bond capital were replaced with equity. However, this alternative might prove expensive, and not all issuers may have access to it under current market conditions (SEB, 2022). Gustavsson (11.05.2023) explains that firms who call their hybrids on an expensive market with little investor interest will probably refinance with equity. Then it is either ordinary shares or D-shares that apply (preference shares may also be an alternative, although few corporations still issue this instrument).

A third option is replacing the hybrid with senior debt. This option might prove to be a cheaper funding alternative but would result in the loss of equity treatment on all hybrids (SEB, 2022). Several interviewees have raised the possibility of combining options two and three, thereby replacing the hybrid bond by issuing 50% equity and 50% debt. If the hybrid bond has been assigned 50% equity treatment from credit institutions, this will keep the ratio stable and thereby not cause downgrades (e.g., Interviewee 1, 03.04.2023; Hallberg, 03.04.2023; Johansson, 05.04.2023).

Fourthly, an issuer could opt to replace the hybrid with cash or asset disposals, which could prove to be a cheaper option in the current environment. However, this option also poses the risk of losing all equity content on all hybrids, with some exceptions, and puts negative pressure on ratings (SEB, 2022).

Fifthly, and lastly, an issuer could choose not to call the hybrid, which would result in the removal of equity content on the non-called hybrid if the effective maturity is shorter than 20 years. Additionally, a coupon step-up would occur. However, in the current environment, the mid-swap rate reset is the most significant deterrent to this option (SEB, 2022). In combination with this, many firms probably want to avoid not to call their bonds because of the market convention (Interviewee 1, 03.04.2023). As previously mentioned, the relationship with investors is essential. Consequently, corporations are keen to preserve these relationships and avoid any actions that could harm them, thereby calling the hybrid bond is considered to be crucial. Regarding the market convention of hybrid bonds being called on their first call date, Gustavsson (11.04.2023) contends that it is difficult to predict the implications if SBB decides not to call their hybrid instrument. "*It's hard to say, and it's probably something that the company is thinking about as well*." (Gustavsson, 11.04.2023). On the other hand, if a corporation is in a critical situation and cannot afford to pay it back, then the option to not call is available (Forsberg, 03.04.2023).

6. Discussion

This section will cover the discussion based on the two research questions presented in the introduction.

1. "Why did SBB choose to issue hybrid bonds, and what implications can the instrument have on the company?"

To understand why SBB decided to issue hybrid bonds, we must look at its financial strategy. The strategy aims to maintain a low level of financial risk, diversify its capital structure, and ensure easy access to capital, which brings credit ratings into focus. By following this strategy, SBB has experienced steady and successful growth, supported by low-interest rates that enable cheap funding for executing its growth strategy. SBB has reached the bond market to access cheap financing instead of more traditional bank debt, which has been a trend in the entire real estate sector.

Improving credit rating

According to Kisgen's (2006) study, credit ratings are one of the top priorities for managers when it comes to capital structure decisions, and this is also the case for SBB. In fact, credit rating is considered the most crucial factor for SBB when deciding on its capital structure. This assertion is strongly supported by interviews conducted with SBB's Dimming and Lindahl (20.04.2023) and other interviewees. Maintaining an investment-grade rating and consistently striving towards their long-term targets is crucial for SBB, as it is directly linked to securing better agreements and lower financing costs. Furthermore, Kisgen (2007) remarks that companies that heavily rely on credit ratings will put effort into attaining a favourable rating conducive to their business operations. SBB is active in the public debt market, which the author further argues will make corporations strive to achieve a high credit rating. Our interviews with SBB and independent interviewees evince a substantial dependence on credit ratings. Consequently, SBB's situation bears a striking resemblance to Kisgen's (2007) observations. It appears that the issuance of hybrid bonds is a deliberate and strategic step toward obtaining its target credit rating.

To obtain 50% equity treatment on their hybrid bonds, corporations must design their instruments following the methodologies prescribed by their respective rating agencies, as outlined in section 4.5 and further elaborated on in section 5.3. This emphasis on credit rating optimisation, and consequent structuring of hybrid bonds, demonstrates the impact that credit rating agencies have on SBB's choice of capital structure. To achieve the desired equity treatment, SBB must tailor their instruments to the requirements of the rating agencies, and it thus can be inferred that credit rating agencies have a significant influence in shaping the financial decisions of SBB.

Although hybrid bonds come with a higher cost than standard bonds, SBB has opted for this financial instrument to enhance its credit rating. As Forsberg (03.04.2023) explained, issuing more costly instruments such as hybrid bonds can improve credit rating and lead to, e.g., reduced financing expenses. Therefore, ultimately, the costs incurred for these instruments may be perceived as justifiable. It is worth noting that hybrid bonds are categorized as equity under IFRS and are often less expensive than other equity options (provided that no step-ups have taken place). On the other hand, hybrid bonds receive less equity treatment from credit rating institutions (max. 50%) compared to common shares (100%).

Rauh and Sufi (2010) discuss that firms with high credit quality typically rely on senior unsecured debt and equity. In contrast, firms with lower credit quality use multiple types of debt, such as secured, senior unsecured, and subordinated issues. However, our collected data suggest that SBB has strategically used the issuance of hybrid bonds to enhance credit rating further. Even when later achieving an investment grade rating, SBB continued to issue hybrid bonds, which is not in line with the paper's findings. In contrast to the findings of Rauh and Sufi (2010), who suggest that firms with high credit quality generally avoid subordinated bonds, SBB has persistently employed heterogeneous debt issuance to improve its credit rating.

Bond market actions and liquidity

Based on the interviews conducted, it appears that SBB places a higher value on the lower cost of financing associated with an investment grade rating than on concerns about liquidity in the bond markets. Kisgen (2006) suggests that firms are most concerned about rating levels when it affects liquidity, but for SBB, this does not seem to be the case. However, the bond market's liquidity is still crucial for SBB, and it is one of the reasons why the company entered the European bond market, as mentioned by Dimming (20.04.2023) and Johansson (05.04.2023). Furthermore, the European bond market also opens for issuing more significant amounts of bonds and hybrid bonds and broadens the investor base.

Being active in the bond markets, an investment grade rating is crucial for SBB to attract capital as it signals financial stability, as Hallberg implies (03.04.2023). Other interviewees (e.g., Gustavsson, 11.04.2023) suggest that there may be forced selling of SBB's bonds if the company is downgraded to high yield due to mandates. Baghai, Becker, and Pitschner (2022) found that credit ratings are widely used in funds marketed to both consumers and institutional investors, with their use increasing in both U.S. and Europe over the last decade. The authors note that credit ratings have been used in the U.S. for over a century, while usage in Europe is relatively recent. Our interviewee's statement aligns with Baghai, Becker, and Pitschner's (2022) findings, which underscores SBB's need for an investment grade rating even more. In turn, it provides a clear background as to why SBB has issued large amounts of hybrid bonds. Baghai, Becker, and Pitschner (2022) also note that the references to credit ratings in mandates have increased, indicating their growing importance in attracting European investor capital. This finding suggests that SBB will likely continue relying on credit rating to attract investment capital for its future capital structure.

Through our interviews, one idea that emerged was the decision by SBB to access the foreign currency Euro bond market to secure more significant funding. Aiming to expand the investor base prompts the corporation to prioritize credit rating while determining its capital structure due to mandates and signalling effects. Since SBB is not as widely recognized in foreign markets as in the local Swedish market, being an investment grade-rated issuer may carry a higher importance for its Euro-denominated securities than domestic issuances, as discussed by Interviewee 2 (11.04.2023). This underscores the significance of credit ratings in facilitating access to foreign capital markets, particularly for less foreign-established corporations seeking to expand their issuance to larger capital markets beyond their home markets.

Other reasons for issuance

Gustavsson (11.04.2023) pointed out that some corporations choose to issue hybrid bonds even if they do not have a credit rating. This is because of the equity treatment and tax-deductible coupons that the bonds receive under IFRS. Our interviewees mentioned this as the second most important reason for SBB to issue hybrid bonds. Therefore, the emphasis on credit ratings when it comes to issuing hybrid bonds can be seen from a different perspective based on these observations. Another advantage of issuing hybrid bonds is their flexibility, such as optional interest deferral, which contributes to the instrument's popularity.

As previously mentioned, these bonds can be kept for a long period, even perpetually, if necessary. Forsberg (03.04.2023) highlighted that hybrid bonds offer a reliable long-term financing option if the corporation does not want to or cannot exercise the call option. The perpetual feature of hybrid bonds is the primary reason credit rating institutions assign equity content to this type of instrument. Furthermore, the equity content disappears when a hybrid bond enters an effective maturity period of less than 20 years, which limits the incentives to keep the bonds perpetually. Although, it is worth noting that the flexible nature of hybrid bonds can be advantageous in volatile market conditions, allowing corporations to maintain access to long-term funding without incurring the risk of default. Nonetheless, our interviews suggest that for SBB, the emphasis remains on maintaining a favourable credit rating and adhering to established market conventions.

Moreover, an intriguing discrepancy has been shown concerning hybrid bonds and their ability to act as secure long-term financing. Credit rating agencies' methodologies, as illustrated in section 4.5 and in a statement from Forsberg (03.04.2023), confirmed that the option of not calling the hybrid bond is always available. When a corporation finds itself in challenging or critical circumstances, the instrument ensures long-term financing without the looming threat of default. Even if the market convention is to call them at the first call date after five to six years, it still provides a relatively stable and long-term source of capital for the real estate sector. In the current challenging economic climate, the probability of issuers being unable to call these instruments has increased, but this option is still viewed as a last resort.

Our interviews indicate that issuers do not perceive the instrument as a reliable and secure source of long-term financing; instead, as previously mentioned, their incentives to call and adhere to market conventions are stronger. The relationship with bond market investors is crucial, and they generally expect to receive their investment back within five to six years when the first call date approaches. Therefore, market conventions view hybrid bonds differently than how IFRS and credit rating institutions perceive them. Due to these observations, we do not see the perpetual feature of hybrid bonds as one of the main reasons for SBB to issue hybrid bonds, even though the instrument often provides long-term financing at a lower cost than other equity.

2. "How are the hybrid bonds generating value for the company, its shareholders, and investors?"

As discussed, hybrid bonds have a positive impact on credit rating and have therefore enhanced SBB's growth journey by lowering the company's financing costs and reaching a larger investor pool. It can be argued that the focus on credit ratings creates value for SBB, as an indicator of financial stability from credit rating institutions will lead to beneficial refinancing terms as well as easier access to capital. But, the instrument is very risky in uncertain markets, with unknown and adverse outcomes for the company, its shareholders, and investors.

Credit rating and flexibility

Since its inception in 2016, SBB has publicly announced its intention to strengthen its credit ratings and become one of the largest real estate companies in the Nordic region. To do so, the company required capital to fuel its growth ambitions. At the same time, SBB needed to ensure that this capital did not significantly worsen its indebtedness, which could prevent it from improving its credit rating. Between 2017-2021, SBB’s issuance of hybrid bonds generated large amounts of capital and simultaneously contributed with equity content from a credit rating perspective. In a low-interest environment, this strategy of using hybrid bonds proved beneficial for the company, as the company received an investment grade rating and continued its growth (see section 5.6.1). This approach was a positive value add for SBB’s shareholders as it allowed the company to improve its credit rating without, e.g., having to issue shares and dilute its current shareholders.

Hybrid bonds do not only contribute to credit rating improvements but can also offer additional mechanisms for the issuer, making them a highly versatile funding option. As stated in section 4.1.1 and highlighted by Gustavsson (11.04.2023), hybrid bonds possess the quality of tax-deductible coupons, allowing the company to gain a more significant advantage from the tax shield (in comparison to, for example, D-shares). The use of hybrid bonds also has a positive value add for the issuer in that the deferral of interest payments will not put the company in default. This is compared to a traditional bond, which will put the company in default if the coupons are not paid. Additionally, the loss absorption mechanism of hybrid bonds will serve as a security for more senior debt holders, while SBB's common shareholders will be further down in the payment schedule in case of default. These loss absorption mechanisms in hybrid bonds can be perceived as beneficial or disadvantageous, depending on the investor's perspective.

An interesting point of discussion is also the different perceptions of hybrid bonds among stakeholders. SBB structures its hybrid bonds under IFRS rules to be classified as 100% equity on its balance sheet. However, credit rating institutions assess each instrument and can only assign a maximum of 50% equity treatment. Furthermore, the equity content can be lost if the instrument is redeemed without new issuance of similar equity content. Analysts covering SBB almost always assign the instrument as 100% debt when calculating its key ratios, such as interest rate coverage and debt-to-equity, resulting in mixed results to the ones presented in SBB's reports. The impact of these differences on the company's value is uncertain, but further disclosure about these differences by SBB could benefit all stakeholders and the company's attractiveness.

Liability management

Johansson (05.04.2023) mentioned the opportunity for SBB to buy back its outstanding hybrid bonds at a lower price, lowering the outstanding amounts, which SBB has proceeded with within the secondary market. Although this strategy can be very beneficial for the company and equity holders, the limitation from the rating institution regarding the maximum buyback amount of 10% per annum hinders SBB from fully utilising this strategy. Given that the company has EUR 1,350m and SEK 1,797m of outstanding hybrid bonds (SBB, 2022a), the annual repurchase limit of 10% still creates an effect. However, the remaining outstanding amounts will still be significant compared to its total equity and liabilities. Furthermore, as Johansson (05.04.2023) explains, the holder of the hybrid bonds will not benefit from the bonds trading at "worst", which could potentially harm the appeal of investing in comparable instruments issued by the company the future.

Vallée's (2019) study explores contingent capital triggers and their relation to liability management exercises during the financial crisis in the highly regulated banking sector. Although, similarities can also be drawn between the real estate sector and the issuance of hybrid bonds. SBB's recent market repurchases bear similarities to banks' LMEs discussed by Vallée (2019) since the repurchases increase the equity component and decrease liabilities. The differential between the repurchase price and the nominal value contributed to the equity ratio. Banks used LMEs with tender offers to bondholders at the first call date instead of calling at par. Even though repurchases in the market have similarities with banks' LMEs, the strategy applied on the first call date will not be feasible for corporations considering credit ratings due to today's interest rate environment. If a company chooses not to call the bonds and repurchases more than 10% of its outstanding hybrid bonds, it runs the risk of losing the equity content unless similar instruments are employed as replacements. Issuing new hybrid bonds is, as mentioned by Gustavsson (11.04.2023), at present expensive. It could therefore be thought that credit rating institutions, in high-interest environments, protect the majority of hybrid bondholders from being pressured into being paid below par for their investments.

Vallée (2019) further demonstrated that banks violated the absolute priority rule during the financial crisis when launching tender offers instead of calling their instruments at par. Similarly, SBB’s repurchases of their hybrid bonds at low prices impose losses on their hybrid bondholders instead of the more junior equity holders. This is in line with what was highlighted by Gustavsson (11.04.2013) that SBB put their more senior bondholders in a worse position by prioritizing subordinated debt. Worth noting is that the investors of SBB’s hybrid bonds sell voluntarily and that SBB is creating liquidity in a volatile secondary market. Contrarily, the banks under the financial crisis put pressure and left the investors with little choice. The restrictions placed by credit rating institutions on repurchasing up to 10% of hybrid bonds also act as an obstacle to the violation of the absolute priority rule. They will, therefore, not reach the same degree as observed in the paper by Vallée (2019).

It is shown that banks that have implemented LMEs may have higher costs connected to subsequent bond issuance, implying a potential decrease in investor demand. Similarly, even though the owners of SBB's hybrid bonds are not required to participate in the recent buybacks, it could be considered a breach of the absolute priority rule and resulting in losses for hybrid bondholders, therefore failing to meet investors' expectations. In line with Vallée's (2019) research, SBB's repurchases may potentially result in a decline in investor interest in such types of bonds. Here, a connection can be made to statements from Forsberg (03.04.2023) and Gustavsson (11.04.2023) that the market reaction if hybrid bonds are not called is uncertain and is thought to lead to less investor interest in the future since they do not want their capital looked in for unknown periods. In this context, we can establish a link between the statements made by Forsberg (03.04.2023) and Gustavsson (11.04.2023), suggesting that if hybrid bonds are not called, the market's response becomes uncertain. It is thought that this uncertainty would result in decreased investor interest since investors are averse to having their capital locked in for unknown durations.

Going forward

In light of current market conditions, Gustavsson (11.04.2023) highlights a potential threat to the previously successful approach of issuing hybrid bonds. This approach aimed to raise significant capital while providing equity content from a credit rating standpoint. In 2019, SBB used tender offers to buy back their outstanding hybrid bonds and replaced them with cheaper ones. Such actions were taken as "*pure liability management decisions"* due to market conditions (Dimming, 20.04.2023), and similar actions could be taken in the future. However, given the current market conditions, it is possible that pursuing similar strategies could become more costly and less viable for SBB. The limitations surrounding the issuance of new hybrid bonds, coupled with increased operational expenses and the challenges of refinancing debt without raising interest payments, have introduced uncertainty for SBB as well as its investors and shareholders. The hybrid bonds may no longer serve as a positive value-add to the company in the same way and thus will require a lot of work for the company to keep its rating when the call date approaches. The uncertainty surrounding if the hybrid bonds will be called or not in the future is displayed in hybrid bonds trading at low prices, according to Johansson (05.04.2023).

The financial crisis prompted banks to re-evaluate their call strategies (Vallée, 2019), akin to the current challenges faced by the real estate industry due to escalating interest rates. According to Vallée (2019), the change of strategy was particularly pronounced for financial institutions with low capitalization. In line with this finding, it can be thought that highly indebted real estate corporations may face more significant challenges at the first call date compared to those with less debt. As SBB's strategy has been to grow while focusing on its journey to receive a high credit rating, the high-interest rates environment, inflation, and the expensive bond market have greatly affected SBB. As previously discussed, in a low-interest rate environment, the first option would have been to issue a new hybrid bond. Nevertheless, hybrid bonds are currently expensive, and there is minimal investor interest in them (Gustavsson, 11.04.2023; Hallberg, 05.04.2023). This scenario resembles the shift in banks' call strategy during the financial crisis, and our collected data suggest that there will likely be a similar shift in the Swedish real estate industry.

Owing to market conventions and the unpredictable market response in the event of not calling a hybrid bond, our interviewees have expressed that the most probable course of action on the call dates in the Swedish real estate sector would be for the issuer to exert every effort to call the hybrid bonds. Since many issuers emphasize credit rating, they are likely to aim to substitute the hybrid bonds with instruments that remain the equity treatment. The most advocated option at the call date would be to call the hybrid bond and replace it with a combination of 50% equity and 50% debt to maintain the equity content (as examined in Section 5.7). This course of action would create a dilutional effect for shareholders. However, it is noteworthy that it would generate less of a dilutional impact than substituting the whole hybrid bond with equity. However, as many interviewees state, it is impossible to know how the market will look at the time of their hybrids' first call dates, and the ability to roll over their hybrids might not pose a challenge.

Concerning the 50% debt portion assigned by credit rating institutions, both bank debt and the bond market are feasible options. Interviewee 1 (03.04.2023) raised one opinion: SBB's dependence on the bond market might have restricted its association with Swedish banks. However, other interviewees (Hallberg, 05.04.2023; Lindahl, 20.04.2023) have argued that SBB still maintains favourable relationships with the banking system. Therefore, if the bond market poses challenges during the refinancing of its hybrid bonds with high prices, as discussed in section 5.5, SBB may opt to consider bank debt as a viable alternative.

Furthermore, most of SBB’s hybrid bonds are issued in EUR and have a fixed rate. Therefore, it is essential to note that these hybrid bonds have not, per se, increased the company’s financial obligations in terms of interest payments by much. Therefore, the main challenge for SBB is the upcoming call dates, its debt maturity profile (see Table 2), and what action it should take. SBB must also consider the potential impact on not just the company itself but also its shareholders and investors. As Gustavsson (11.05.2023) and Hallberg (05.04.2023) described, the issuance of hybrid bonds will probably not be witnessed soon due to its increased cost, necessitating the search for an alternative solution.

7. Conclusion

This paper analyses Samhällsbyggnadsbolaget i Norden’s (“SBB”) issuance of hybrid bonds and what implications it has had on the corporation, as well as how it has generated value for the corporation, shareholders, and investors. Historically, the issuance of hybrid bonds has proven advantageous, as it represents a strategic choice aimed at achieving the targeted credit rating of SBB, which is the primary goal when optimizing the corporation's capital structure. An investment grade rating has served as a solid foundation for the company's growth strategy and has enabled it to secure favourable financing terms and conditions. Therefore, hybrid bonds are concluded to be a valuable choice for the company overall. When reaching international investors, it might be more important and have a stronger signalling value than in the domestic market where SBB is well known. The investment grade rating has also been vital due to investment mandates and to reach a large investor base, with the mandates increasing in Europe during the latest years. In a market with low-interest rates, the issuance has worked in SBB's favour providing a secure, partly equity-treated financing alternative, which created value for the corporation and shareholders. Further, for the more senior investors in SBB, the hybrid bonds serve as a loss-absorbing buffer. By avoiding dilution and enhancing credit ratings, the issuance of hybrid bonds brings several advantages for common equity holders. Not only does it help them secure better financing terms, but it subsequently enables growth opportunities for the company. In terms of value creation from the hybrid bonds in a market with rising interest rates, it still contributes with long-term financing, the option to defer interest in a stressed market, and the bonds issued on the European market have fixed rates. Therefore, one can argue that the instruments are stable on the company’s balance sheet and will be until the first call date. Nevertheless, we have concluded that regulators, rating institutions, and analysts often have divergent perspectives and treatments regarding hybrid bonds. Such discrepancies can potentially be viewed as a drawback for the company due to the view on the instrument's attributes and subsequent risk.

However, our findings suggest concerns regarding uncertainties surrounding the functioning of hybrid bonds in high-interest environments and the company's strategy when approaching call dates. Among rising interest rates and market turbulence, SBB faces concerns regarding the likelihood of calling its hybrid bonds, disrupting market conventions. In response to these uncertainties, SBB has capitalized on the negative perception from market participants by repurchasing its hybrid bonds at a discounted price. We find that this decision has raised questions about its impact on more senior creditors, as the loss-absorbing mechanism of hybrid bonds decreases their protection. However, the favourable discount improves overall company stability and contributes to the equity ratio.

Due to the difficulties surrounding the first call date, our interviews indicate that hybrid bonds as an instrument will likely become less popular in the future. The implications the call date strategy can have on the company, shareholders, and investors are hard to know beforehand. Still, the market convention to call is strong, which creates a discrepancy around the instrument since it is given equity treatment because of its perpetuity. The value created by the instrument in the future will therefore depend on the market conditions and SBB's choice of strategy at the first call date.

We believe that there exist many areas for future research related to the topic of this paper. It would be interesting to study what actions will be undertaken by Swedish real estate companies on the hybrid bond's first call date. Additionally, since SBB strongly emphasises credit ratings, we also find it valuable to explore the potential consequences of a downgrade. After completing this paper, SBB has experienced a downgrade by S&P to BB+ with a negative outlook. A downgrade had only been a subject of speculation within our data collection, and it would therefore be interesting to examine the implications of a downgrade. Research may also examine the disparities between credit rating institutions' methodologies, which assign equity content of up to 50% for hybrid bonds, and the IFRS standards, which classify hybrid instruments as having 100% equity content. This analysis can shed light on the differences, similarities, and potential consequences of these approaches to hybrid bond assessment.

8. References

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Date of interview	Interviewee Name	Interview Format
03.04.2023	Interviewee 1	In-person
03.04.2023	Ylva Forsberg	In-person
05.04.2023	Philip Hallberg	In-person
05.04.2023	Michael Johansson	In-person
11.04.2023	Interviewee 2	In-person
11.04.2023	Marcus Gustavsson	Virtually
20.04.2023	Marika Dimming	Virtually
20.04.2023	Helena Lindahl	Virtually

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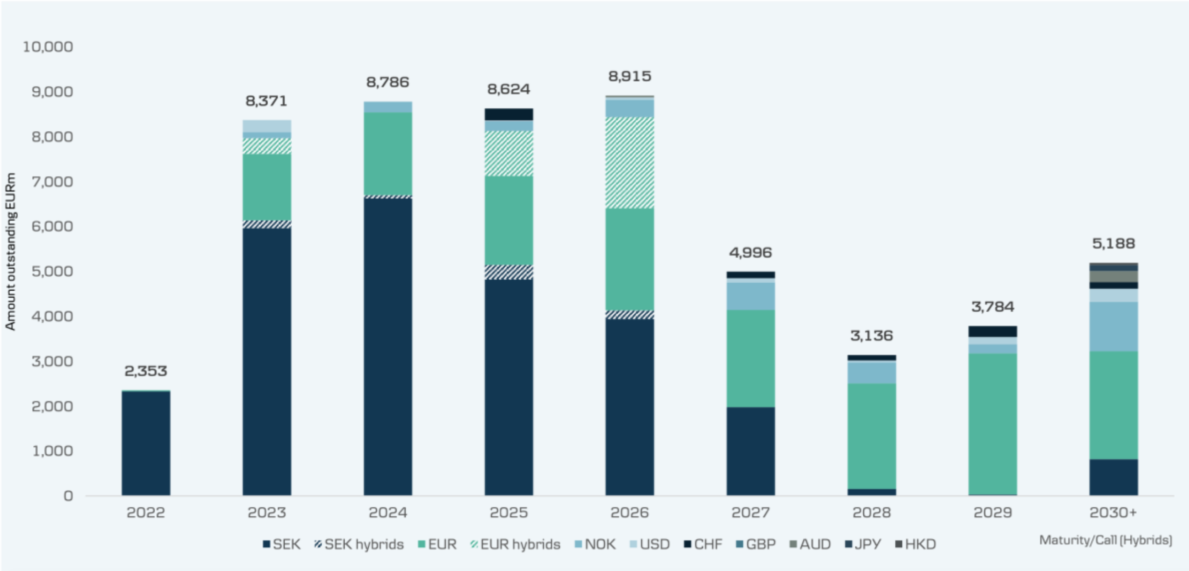
9. Appendix

9.1 Maturity profile of Swedish real estate issuers' outstanding bonds, in all currencies



Source: Danske Bank Credit Research, 2022

9.2 Summary of hybrid bonds in EUR

Issue Date	**April 2019**	**January 2020**	**December 2020**	**June 2021**
Outstanding Amount	*EUR 300m*	EUR 500m	EUR 500m	EUR 500m
Buyback amount	*EUR 300m in 2021*	EUR 46m	EUR 43m	EUR 61m
Tenor at issue	*Perpetual*	Perpetual	Perpetual	Perpetual
Issue Rating	*BB, BB by S&P & Fitch (Issuer rated BB & BBB- by S&P & Fitch)*	BB, BB, BB+ by S&P, Fitch & Scope (Issuer rated BBB- & BBB by S&P & Fitch at issue)	BB, BB, BB+ by S&P, Fitch & Scope (Issuer rated BBB- & BBB by S&P & Fitch at issue)	BB, BB, BB+ by S&P, Fitch & Scope (Issuer rated BBB- & BBB by S&P & Fitch at issue)
Rating Agency Equity Credit	*50% equity credit*	50% equity credit	50% equity credit	50% equity credit
IFRS Accounting	*Equity*	Equity	Equity	Equity
Ranking	*Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness,*	Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness,	Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness,	Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness,

	senior to ordinary share capital only	senior to ordinary share capital only	senior to ordinary share capital only	senior to ordinary share capital only
Time to the first call date	*5.25 years (26 July 2024)*	5.25 years (30 April 2025)	5.25 years (14 March 2026)	5.6 years (20 January 2027)
Coupon to first step-up	*4.625%*	2.624%	2.625%	2.875%
Margin step-up	+25 bps (after 10.25 years) +75 bps (after 25.25 years)	+25 bps (after 10.25 years) +75 bps (after 25.25 years)	+25 bps (after 10.25 years) +75 bps (after 25.25 years)	+25 bps (after 10.6 years) +75 bps (after 25.6 years)
Interest deferral	*Optional deferral – cash cumulative & compounding*	Optional deferral – cash cumulative & compounding	Optional deferral – cash cumulative & compounding	Optional deferral – cash cumulative & compounding
Call upon Change of Control (CoC)	*Yes, otherwise 500 bps step-up*	Yes, otherwise 500 bps step-up	Yes, otherwise 500 bps step-up	Yes, otherwise 500 bps step-up
ISIN	*XS1974894138*	XS2010032618	XS2272358024	XS2010028186
EIKON	*SE197489413*	SE201003261	SE227235802	SE201002818

Source: Source: SBB, 2019b; SBB, 2020a; SBB, 2020b, SBB, 2021a; EIKON, 2023

9.3 Summary of hybrid bonds in SEK

Issue Date	**September 2017**	**September 2018**	**October 2019**	**October 2019***
Outstanding Amount	*Framework of SEK 1,000m Issued SEK 700m in Sep 2017 Issued SEK 300m in Sep 2018*	*Framework of SEK 1,500m Issued SEK 1,000m in Sep 2018 Issued SEK 100m in Oct 2018 Issued SEK 100m in Oct 2018*	SEK 1,500m	SEK 575m
Buyback amount	*300 Dec 2018 700 2019*	*SEK 1,200m Dec 2019*	SEK 0	SEK 278m
Tenor at issue	*Perpetual*	*Perpetual*	Perpetual	Perpetual
Issue Rating	*NR*	*NR (Issuer rated BB & BB by S&P & Fitch at issue)*	NR (Issuer rated BBB- & BBB- by S&P & Fitch at issue)	Not rated
Rating Agency Equity Credit	*n.a*	*n.a.*	50% equity credit	50% equity credit
IFRS Accounting	*Equity*	*Equity*	Equity	Equity

Ranking	*Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness, senior to ordinary share capital only*	*Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness, senior to ordinary share capital only*	Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness, senior to ordinary share capital only	Deeply subordinated. Junior to only all unsubordinated obligations and subordinated indebtedness, senior to ordinary share capital only
Time to the first call date	*5.5*	*5.5 (13 March 2024)*	5.25 (28 January 2025)	5.25 (7 January 2025)
Coupon to first call date	*3m STIBOR + 700 bps*	*3m STIBOR + 635 bps*	3m STIBOR + 350 bps	3m STIBOR + 685 bps
Coupon step-up	*2028* *2043*	*+ 25bps (after 10.5 years, 2029)* *+ 75 bps (after 25.5 years, 2044)*	+25 bps (after 10.25 years) +75 bps (after 25.25 years)	+25 bps (after 10.25 years) +75 bps (after 25.25 years)
Interest deferral	*Optional deferral – cash cumulative & compounding*	*Optional deferral – cash cumulative & compounding*	Optional deferral – cash cumulative & compounding	Optional deferral – cash cumulative & compounding
Call upon CoC	*Yes, otherwise 500 bps step-up*	*Yes, otherwise 500 bps step-up*	Yes, otherwise 500 bps step-up	Yes, otherwise 500 bps step-up
ISIN	*SE0010414599*	*SE0011642776*	SE0013359148	SE0013234531
EIKON	*SE0010414599*	*SE0011642776*	SE0013359148	SE0013234531

**Offentliga hus*

Source: Source: SBB, 2017a; SBB, 2018a; SBB, 2019a; Offentliga hus, 2019; EIKON, 2023

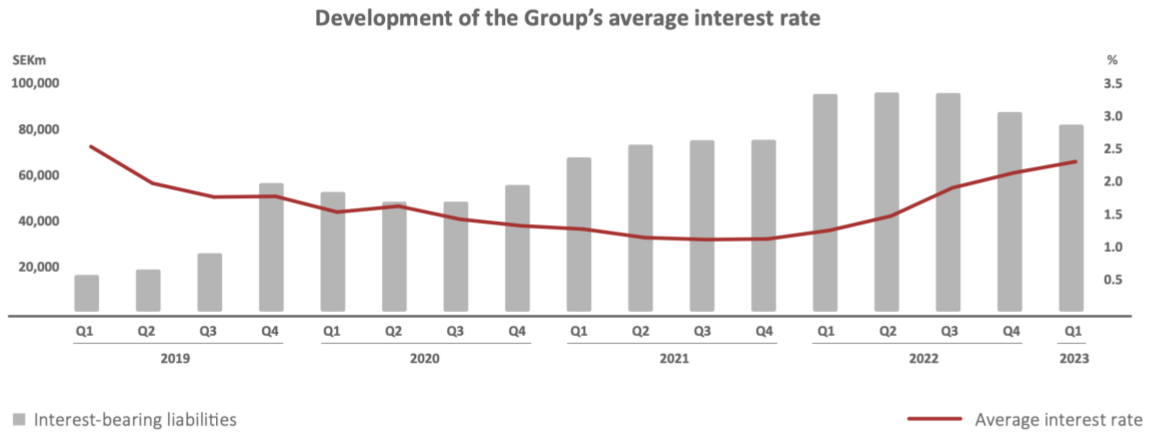
9.4 Samhällsbyggnadsbolaget I Norden, Class B-shares

Source: Avanza

9.5 Samhällsbyggnadsbolaget I Norden, Class D-shares

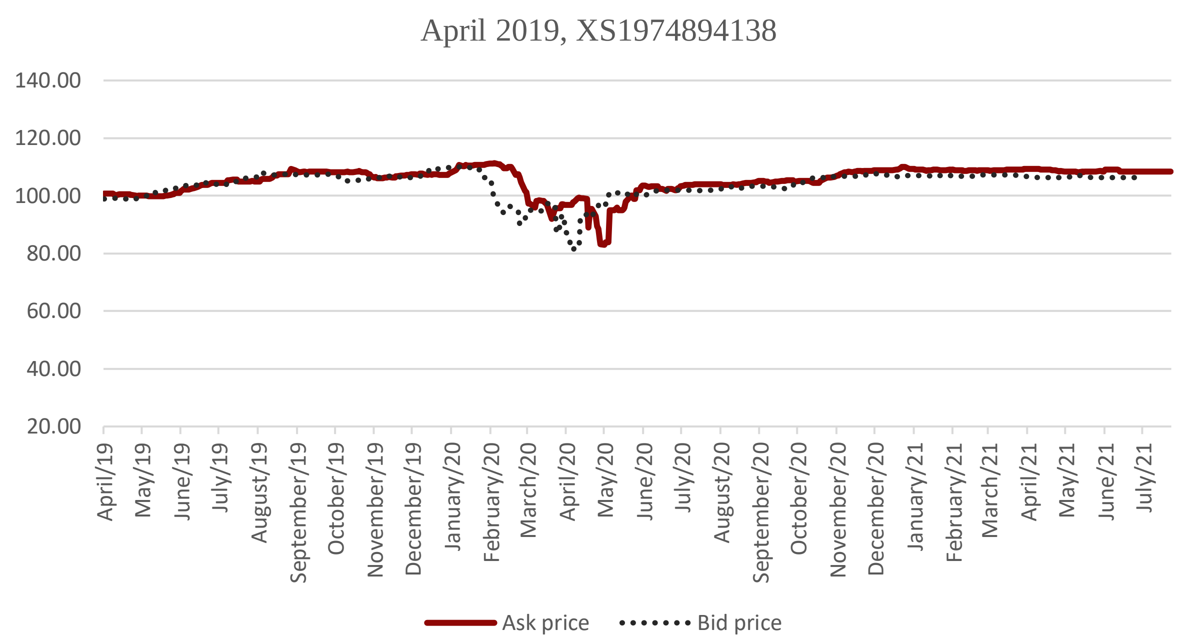
Source: Avanza

9.6 Average interest rate historically



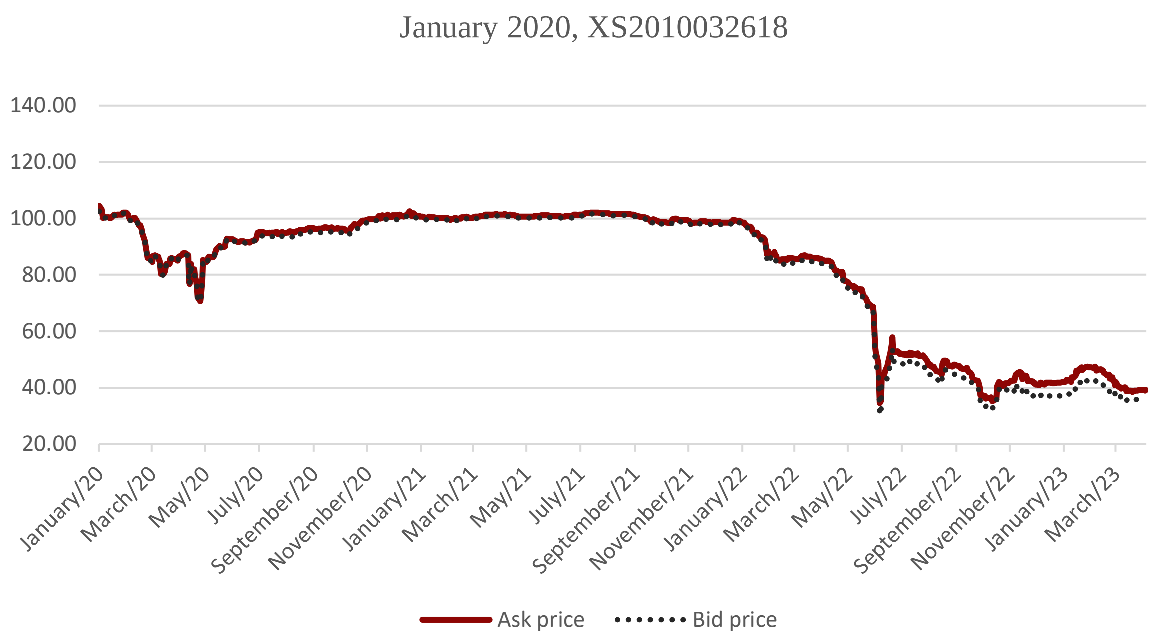
Source: SBB, 2023

9.7 Bid and ask price hybrid bond, ISIN XS1974894138 (EUR Issuance)



Source: Eikon, 2023

9.8 Bid and ask price hybrid bond, ISIN XS2010032618 (EUR Issuance)

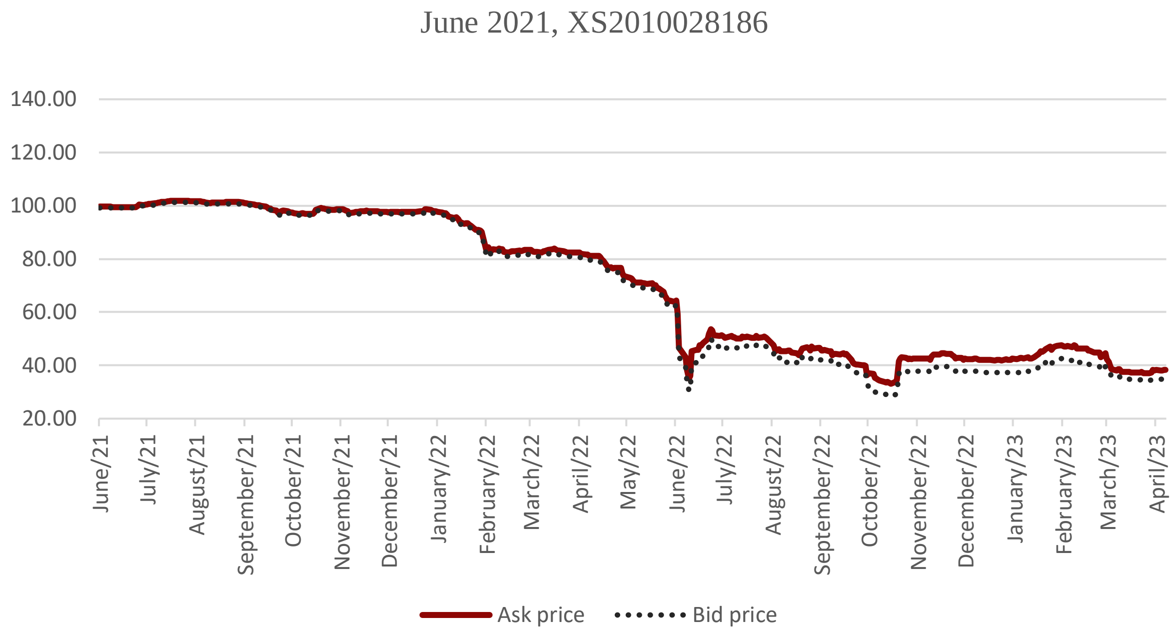


Source: Eikon, 2023

9.9 Bid and ask price hybrid bond, ISIN XS2272358024 (EUR Issuance)

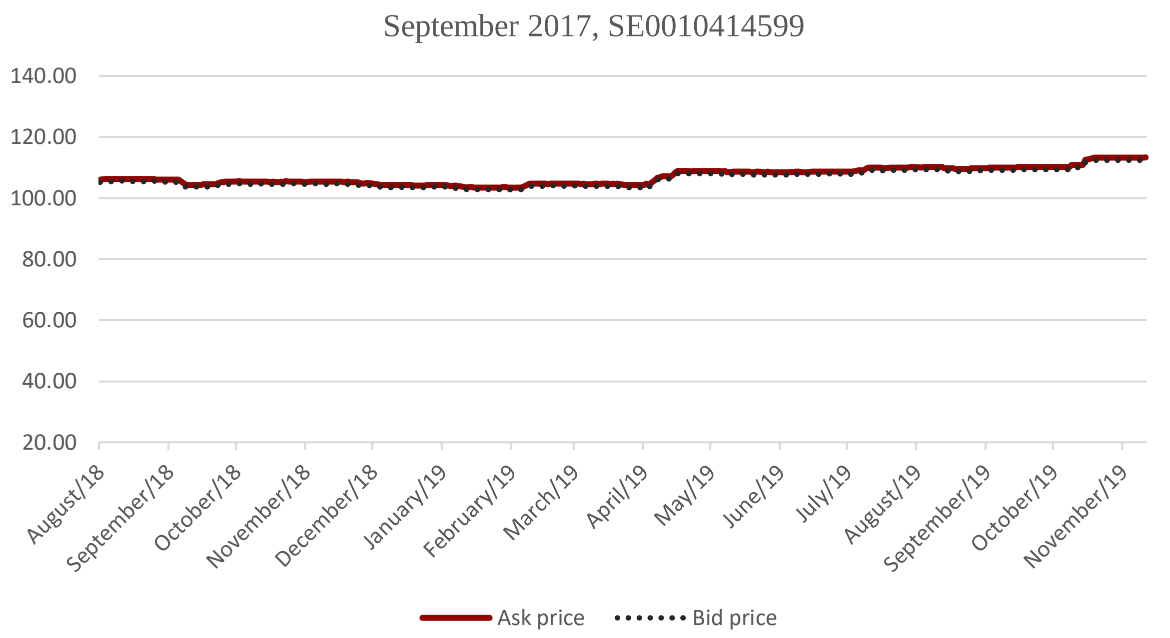
Source: Eikon, 2023

9.10 Bid and ask price hybrid bond, ISIN XS2010028186 (EUR Issuance)



Source: Eikon, 2023

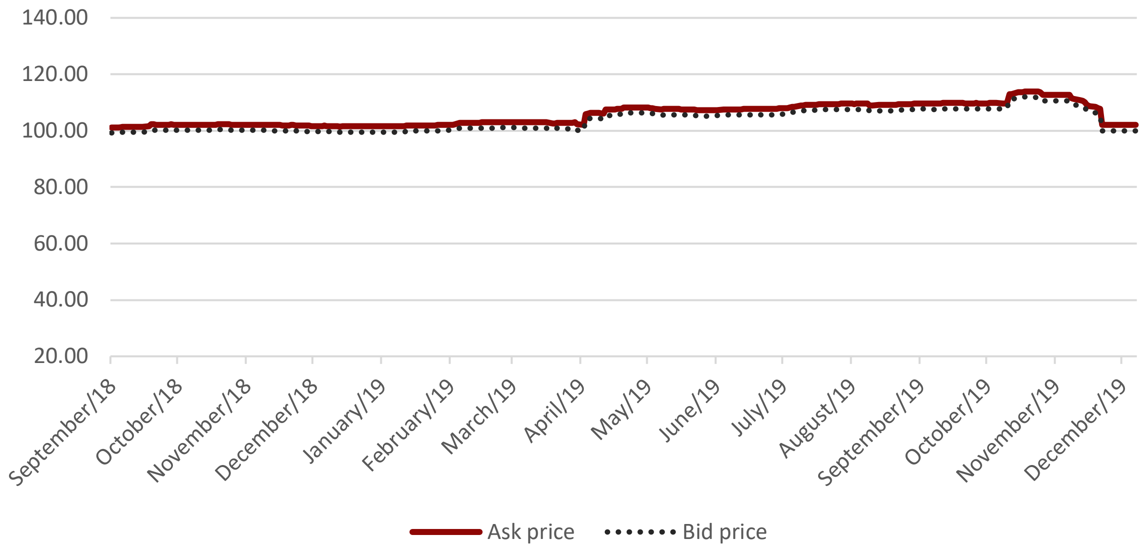
9.11 Bid and ask price hybrid bond, ISIN SE0010414599 (SEK Issuance)



Source: Eikon, 2023

9.12 Bid and ask price hybrid bond, ISIN SE0011642776 (SEK Issuance)

September 2018, SE0011642776



Source: Eikon, 2023

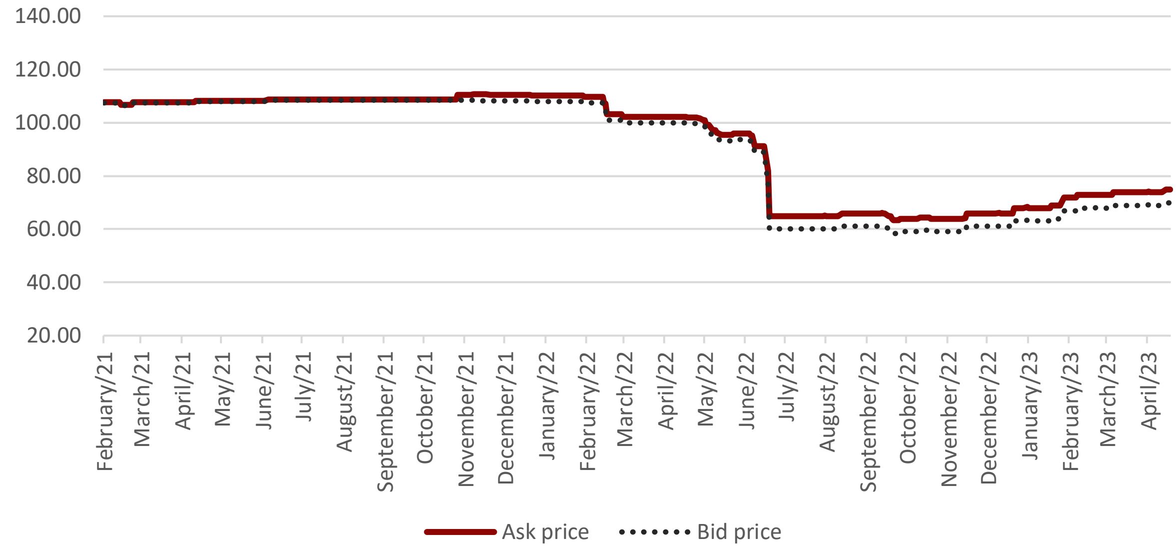
9.13 Bid and ask price hybrid bond, ISIN SE0013359148 (SEK Issuance)

October 2019, SE0013359148

Source: Eikon, 2023

9.14 Bid and ask price hybrid bond, ISIN SE0013234531* (SEK Issuance)

October 2019, SE0013234531*



**Issued by Offentliga hus*

Source: Eikon, 2023