

Research Update:

Swedish Municipality of Östersund 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

April 14, 2023

Overview

- Large investments, mainly related to energy company Jämtkraft, are likely to require material debt financing and push up the Municipality of Östersund's debt through 2025.
- To cater for an expanding debt burden, and occasional liquidity peaks at Jämtkraft, Östersund has tightened its reserve practices and structurally improved its liquidity position.
- Although inflationary pressures and rising pension costs will weigh on Östersund's operating performance, strong tax-revenue growth, efficiency measures, and dividends will ease the effects and support sound performance.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Östersund. The outlook is stable.

Rating Action

On April 14, 2023, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on the Swedish Municipality of Östersund. The outlook is stable.

At the same time, we affirmed our 'K-1' short-term Nordic regional scale rating on Östersund.

Outlook

The stable outlook reflects our view that healthy tax-revenue growth and prudent fiscal discipline will support sound budgetary performance, with Östersund upholding a solid liquidity position.

Downside scenario

We could lower the rating if we observe laxer management practices, leading to deteriorating cost control, worsening budgetary performance, and weaker liquidity.

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Upside scenario

We could consider a positive rating action on Östersund if we observe tighter governance of the municipality's energy company, including its debt and the effects of hedging positions. In such a scenario, we would expect Östersund's debt burden to materially improve.

Rationale

The affirmation reflects our view that Östersund, located in Sweden's north, will uphold sound operating performance through our forecast period to 2025, despite rising cost pressures. We forecast the municipality's own capital expenditure (capex) will normalize from very high levels in 2022, yielding deficits after capital accounts of less than 5% of revenue. However, owing to Jämtkraft's ambitious investment plans, we expect a notable increase in the municipality's debt burden in the coming years. Furthermore, we expect management will remain committed to prudent risk practices and uphold the solid liquidity position.

The supportive institutional framework, and budget discipline counterbalance macroeconomic risks

We consider the political and managerial strength in Östersund at par with domestic peers. The incumbent minority coalition lost power to a two-party majority government, consisting of the Social Democrats and Centre Party, in the elections last year. We don't think the change in political leadership will have any material effects on the municipality's strategies or priorities. In our view, management will remain committed to fiscal discipline and counteract pressures on the municipality's financial position.

Östersund's economy is supported by Sweden's comparably high wealth levels, as seen by our estimated 2023 GDP per capita of \$58,000. We expect sound population growth for the municipality, roughly in line with the national average, from about 65,000 in 2022. The local economy is diversified with a wide range of small- and mid-sized enterprises in various industries. Unemployment, at 4.8% by year-end 2022, is better than the national average.

We assess Sweden's institutional framework as extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the local and regional government (LRG) sector's revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. Central government support for the sector was displayed, for instance, during the COVID-19 pandemic, when it implemented direct and indirect support packages to boost municipalities' performance.

Company-sector investments will push up debt

We expect sound operating performance from Östersund through 2025, although at somewhat weaker levels than recent years. We think operating spending will notably increase in the next two years on the back of inflationary pressures, such as rising employee costs and increased pension expenditure. These higher pension costs are partly related to a new pension agreement that will increase the municipality's annual contributions from 2023. In addition, noncash pension provisions will increase in 2023-2024 because the existing pension liability is inflation-linked, although these expenditures will not affect S&P Global Ratings' operating balance.

We expect Östersund to enhance cost control and extract comparably high dividends from its companies in 2023-2025 to mitigate the impact. We forecast dividends will total Swedish krona (SEK) 260 million in 2023-2025, compared to SEK31 million in 2019-2020, and be primarily paid by Jämtkraft. This, in combination with strong tax-revenue growth, will support sound operating performance through 2025. Furthermore, we expect Östersund will remain compliant with the Swedish accrual-based balanced budget requirement and acknowledge that the municipality has about SEK130 million in reserves that can be used to cover regulatory deficits.

We expect the municipality's own capex, primarily related to educational facilities, and water and waste infrastructure, to normalize in 2023 from the all-time high in 2022, which we regard as a one-off driven by a few large projects reaching completion. Therefore, we expect Östersund's deficit after capital accounts will not structurally exceed 5% of revenue.

Among Östersund's companies, we only think Jämtkraft will have borrowing needs through 2025. The company has relatively ambitious investment plans requiring debt funding, and we expect it will borrow SEK500 million annually over the next two years. These loans will be sourced through the municipality's in-house bank. Consequently, we expect Östersund's debt to notably increase in the coming two years, and structurally weaken its position compared to our previous review. We continue to consider the municipality's contingent liabilities, constituting a small amount of extended guarantees, limited.

Like most other Swedish LRGs, the profile of Östersund's debt is short dated from an international perspective. Although we expect a relatively rapid increase in the municipality's interest expenditure, it will be from a low level, remaining below 5% as a share of revenue through 2025. Moreover, about 80% of Östersund's direct debt is on-lent to its companies, who are also servicing its own debt. As a result, the negative effect on the municipality's operating balance is limited.

We now regard Östersund's liquidity position as exceptionally strong, stemming from an ample amount of liquidity sources, covering 146% of average annual debt service, and our view of its strong access to external capital. We note that Östersund has structurally increased its liquidity sources over the past six months, and we expect the coverage ratio will remain solid through 2025.

In our liquidity calculation, we include SEK3.1 billion in cash, financial assets, and backup-facilities. We also include an average of SEK2 billion of maturing debt and interest. In our calculation we exclude cash and backup facilities pertaining to Jämtkraft, since we consider these sources will be needed to cater for the company's occasionally volatile liquidity needs.

Key Statistics

Table 1

Östersund (Municipality of) Selected Indicators

Mil. SEK	2020	2021	2022e	2023bc	2024bc	2025bc
Operating revenues	5,284	5,523	5,833	6,147	6,451	6,579
Operating expenditures	4,896	5,098	5,330	5,729	6,041	6,236
Operating balance	387	426	503	418	410	343
Operating balance (% of operating revenues)	7.3	7.7	8.6	6.8	6.4	5.2
Capital revenues	32	22	19	29	25	29
Capital expenditures	500	705	1,161	743	642	658
Balance after capital accounts	(81)	(258)	(639)	(296)	(207)	(286)

Table 1

Ostersund (Municipality of) Selected Indicators (cont.)

Mil. SEK	2020	2021	2022e	2023bc	2024bc	2025bc
Balance after capital accounts (% of total revenues)	(1.5)	(4.7)	(10.9)	(4.8)	(3.2)	(4.3)
Debt repaid	1,800	1,750	1,900	1,700	2,275	2,250
Gross borrowings	1,800	2,150	3,120	2,555	3,025	3,000
Balance after borrowings	(61)	(71)	(26)	59	43	(36)
Direct debt (outstanding at year-end)	4,875	5,225	6,445	7,300	8,050	8,800
Direct debt (% of operating revenues)	92.3	94.6	110.5	118.8	124.8	133.8
Tax-supported debt (outstanding at year-end)	5,074	5,420	6,636	13,300	14,550	15,800
Tax-supported debt (% of consolidated operating revenues)	49.6	45.3	40.7	85.8	94.8	108.0
Interest (% of operating revenues)	1.1	1.0	1.3	2.1	2.6	3.6
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	487,872	526,244	566,987	597,815	621,856	641,867

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful. SEK--Swedish krona.

Ratings Score Snapshot

Table 2

Ostersund (Municipality of) Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	2
Liquidity	1
Debt burden	4
Stand-alone credit profile	aa+
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale; 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, April 10, 2023. An interactive version can be found at www.spratings.com/SRI.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S. , July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022
- Most Rated Swedish LRGs Can Absorb Higher Interest Costs, Sept. 12, 2022
- Southern Swedish LRGs Bear The Brunt Of Surging Electricity Prices, July 20, 2022
- Swedish Local Governments Are Holding Up Against Cyber Attacks, Jan. 26, 2022
- Institutional Framework Assessment: Swedish Municipalities And Counties, Dec. 13, 2021

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Ostersund (Municipality of)

Issuer Credit Rating AA+/Stable/A-1+

Nordic Regional Scale --/--/K-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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