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Research Update:

Swedish Municipality Ostersund Outlook Revised To Stable From Positive; 'AA+ / A-1+' And 'K-1' Ratings Affirmed

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Overview

- Östersund's small size relative to its energy utility Jämtkraft makes its debt position vulnerable to the company's business decisions.
- Even though the companies Östersund owns continue to amortize debt, we foresee a risk that potential expansions in the company sector could derail the municipality's ongoing efforts to consolidate the sector's debt.
- We are revising our outlook on Östersund to stable from positive and affirming our 'AA+/A-1+' issuer credit ratings and 'K-1' regional scale rating on Östersund.

Rating Action

On April 20, 2018, S&P Global Ratings revised its outlook on the Swedish Municipality of Östersund to stable from positive.

At the same time, we affirmed our 'AA+' long-term and 'A-1+' short-term issuer credit ratings and 'K-1' short-term Nordic regional scale rating on Östersund.

Outlook

The stable outlook reflects our view that management will uphold strong budgetary performance, leading to a constant debt position and continued exceptional liquidity. We believe the municipal company sector is, to some extent, fueling Östersund's investment plans, which creates some uncertainty regarding potential increases in Östersund's debt.

Downside Scenario

We could lower the rating if we see notable fiscal slippages combined with loosening of financial policies, leading to liquidity deteriorating to below 120% of debt service.

Upside Scenario

We could take a positive rating action if we concluded that the municipality's management had taken firmer control of the energy company's strategy, while maintaining strong budgetary discipline. Combined with only modest financing needs for municipal investments, this could stabilize the municipal companies' debt burden, despite the ongoing transition of their debt to the municipality's in-house bank.

Rationale

We revised our outlook to stable from positive because, in our view, Östersund's control over its utility company's investment decisions has not strengthened sufficiently to sustain longer-term consolidation of the municipal group. In our view, Östersund's relatively small budget compared with its large utility company makes the municipality's overall debt position susceptible to the company's business decisions.

Our assessment of Östersund's creditworthiness continues to reflect our opinion of the municipality's ongoing consolidation efforts. We expect Östersund will maintain stable liquidity and strict budgetary discipline throughout our forecast horizon (2018-2020), resulting in no net new debt compared with the amount outstanding at year-end 2017.

Östersund benefits from a stable equalization system and strong financial management

Population growth in Östersund has picked up since 2012 as people move into the city from neighboring municipalities, and immigration remains high. In 2017, the population expanded by 1.3% to 62,600, compared with flat growth in 1990-2010. We view Östersund's economy as well balanced and increasingly diversified. Because the Swedish equalization system significantly balances wealth levels among local and regional governments (LRGs), we use Sweden's national GDP per capita of \$52,500 as a starting point for our analysis of Östersund's economy.

In our view, Sweden's LRG system displays a high degree of institutional stability. The LRG sector's revenue and expenditure management is based on a far-reaching equalization system and regional autonomy in setting local taxes.

We expect Östersund's financial management team will prudently oversee its performance, debt, and liquidity. The municipality's budgetary execution is strong, exemplified by a track record of robust performance. We expect management will continue to employ sensible debt and liquidity practices as the remaining external debt of the municipal companies is transferred to the in-house bank. We consider that the municipality has maintained an astute approach to refinancing risks, and has demonstrated exceptional liquidity coverage of maturing short-term debt since the in-house bank's inception. Furthermore, we note recent positive developments in management, such as Jämtkraft's placement under a holding company, Rådhus. Other government-related entities, such as housing company Östersundshem, are already operating under the holding company. This notwithstanding, the municipality's actions to strengthen control and governance of the company sector have not reached a level that would lead us to revise our assessment of management. Furthermore, we see as a risk factor that Jämtkraft's commercial decisions and size widely surpass those in the definition of municipal core operations and the municipality's size.

We view as positive Jämtkraft's current focus on amortizing debt over the coming years.

We note that Östersundshem's CEO has recently resigned. We do not expect any impact on the company's operations from this, but will continue to monitor the situation.

Continued strong budgetary performance leads to a stable debt position

We note that, over 2015-2017, the municipality recorded operating balances averaging 5.8% of operating revenues and deficits after capital expenditures of 0.1% of total revenues on average. In our base-case scenario for 2018-2020, we think spending associated with education and elderly care will slightly reduce the municipality's operating balance to 5.3% of operating revenues on average. We anticipate a minimal deficit after capital accounts of 0.9% on average because the municipality's capital expenditures are broadly in line with historical levels over the 2018-2020 planning period.

We think that Östersund has strong revenue flexibility, given the potential for asset sales, as shown over the past few years, and we understand the municipality is contemplating further disposals as it continues to review its property portfolio. Still, we consider its expenditure structure to be fairly rigid, although in line with that of other Swedish peers.

In light of Östersund's expanding treasury functions, its loan portfolio has been growing. Although the municipality currently has very low debt related to its budgetary execution, it owns a large utility company, Jämtkraft (not rated) and a housing company Östersundshem (not rated), both of which have received onlent funds from the municipality. Most of the company sector's external loans have been transferred to the municipality's in-house bank. As of year-end 2017, only Östersundshem has some remaining external loans, which we expect will be transferred in full during 2019. If the municipality sticks to its consolidation efforts, we believe its overall debt position could stabilize at a lower level. We estimate that the municipality's direct debt will decline over the coming years, to about 99% of operating revenues in 2020 from 106% in 2017, thanks to its consolidation efforts, only modest financing need for municipal investments, and repayments from the energy company exceeding onlending to the housing company.

In assessing Östersund's contingent liabilities, we include guarantee commitments and Östersundshem's external debt that is not at the in-house bank, and view them as being generally contained.

We base our view of Östersund's liquidity as exceptional on the municipality's strong internal liquidity, committed bank facilities in relation to volumes of maturing debt, and proven strong access to the capital markets. Östersund's estimated cash balance over the planning period averages about Swedish krona (SEK) 360 million (about \$43 million). Östersund has short-term securities of SEK778 million in its pension fund that it could sell for liquidity purposes if needed. We include these holdings in our liquidity analysis after applying haircuts as prescribed in our criteria. Moreover, Östersund has a total of SEK900 million of unused committed liquidity facilities as well as SEK700 million on a checking account, which it typically leaves untouched. We forecast Östersund's cash and available committed bank facilities at about 161% of debt maturing over the following 12 months. Östersund currently taps the market through a SEK1 billion commercial paper program and a SEK5 billion medium-term note, and it lends most of the issuance proceeds to the company sector. The municipality's capital market

activity has, in line with our expectations, tilted toward longer-term financing as its in-house bank continues to replace outstanding external loans in the company sector with its own sourced funds with longer tenors.

Key Statistics

Table 1

Municipality of Ostersund Key Statistics						
(Mil. SEK)	--Fiscal year end Dec. 31--					
	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	4,214	4,537	4,699	4,793	4,907	5,044
Operating expenditures	3,956	4,277	4,442	4,538	4,656	4,773
Operating balance	258	260	257	255	250	271
Operating balance (% of operating revenues)	6.1	5.7	5.5	5.3	5.1	5.4
Capital revenues	62	1	589	30	43	34
Capital expenditures	236	297	928	335	339	347
Balance after capital accounts	84	(36)	(83)	(50)	(46)	(42)
Balance after capital accounts (% of total revenues)	2.0	(0.8)	(1.6)	(1.0)	(0.9)	(0.8)
Debt repaid	18	150	1,650	1,500	1,350	1,530
Gross borrowings	1,117	850	1,950	1,300	1,450	1,630
Balance after borrowings	172	3	35	5	35	-32
Modifiable revenues (% of operating revenues)	66.5	64.9	65.5	66.2	66.4	66.5
Capital expenditures (% of total expenditures)	5.6	6.5	17.3	6.9	6.8	6.8
Direct debt (outstanding at year-end)	4,000	4,700	5,000	4,800	4,900	5,000
Direct debt (% of operating revenues)	94.9	103.6	106.4	100.2	99.9	99.1
Tax-supported debt (outstanding at year-end)	4,868	4,936	5,217	5,017	5,117	5,217
Tax-supported debt (% of consolidated operating revenues)	57.4	54.3	52.9	49.8	49.7	49.5
Interest (% of operating revenues)	0.4	0.1	0.1	0.1	0.1	0.1
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	430,872	447,142	460,644	477,049	491,629	506,407

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. SEK--Swedish krona. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Municipality of Ostersund Ratings Score Snapshot

Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Average
Budgetary performance	Strong
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	Low

*S&P Global Ratings' credit ratings on local and regional governments (LRGs) are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on an LRG.

Key Sovereign Statistics

Sovereign Risk Indicators, April 10, 2018. An interactive version is also available at <http://www.spratings.com/sri>.

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30,2014
- General Criteria: National And Regional Scale Credit Ratings - September 22,2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15,2009
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - August 14,2017
- General Criteria: Use Of CreditWatch And Outlooks - September 14,2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07,2017

Related Research

- Sovereign Risk Indicators - April 10, 2018. An interactive version is also available at www.spratings.com/sri
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments - September 21, 2017
- 2016 Annual Non-U.S. Local And Regional Government Default Study And Rating Transitions - May 8, 2017
- Swedish Local And Regional Government Risk Indicators: April 2017 Update - April 5, 2017
- High Investments Underpin Growing Debt Levels For Swedish Local And Regional Governments - February 10, 2016

- Public Finance System Overview: Swedish Local And Regional Governments - January 21, 2016

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

	Rating	
	To	From
Ostersund (Municipality of)		
Issuer Credit Rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Positive/A-1+
Nordic Regional Scale	--/--/K-1	--/--/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. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46)

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