

Research Update:

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

October 14, 2022

Overview

- We believe that strong tax revenue growth will mitigate the inflationary pressure on Östersund's performance metrics in 2022-2024, resulting in healthy operating balances structurally above 5%.
- Although we expect investments will temporarily increase until 2024, with continued debt build-up, we weigh into our assessment our view of management's strong commitment to financial stability.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Östersund. The outlook is stable.

Rating Action

On Oct. 14, 2022, 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 and prudent fiscal discipline will keep Östersund's budgetary performance strong and compliant with the balanced budgetary requirement. As such, we expect management will combat budgetary pressure from inflation and interest rates. Furthermore, we expect Östersund's liquidity will remain strong, even though debt will climb because of continued investment needs within both the municipality and the company sector.

Downside scenario

We could lower the rating if management fails to prevent fiscal slippages by not structurally fulfilling the balanced budgetary requirement. Rating pressure would also stem from debt sharply

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increasing beyond our expectations.

Upside scenario

We could take a positive rating action if Östersund's liquidity position strengthens such that debt service coverage ratios improve structurally above 120%. In this scenario, we believe tighter governance of the municipality's energy company, including its debt levels and impact of hedging positions, would further underpin ratings upside.

Rationale

We forecast that Östersund will uphold sound operating performance through our forecast period to 2024, supported by continually strengthening tax revenue as well as the municipality's efficiency measures. We think these factors will mitigate the higher cost pressure related to economic, geopolitical, and demographic changes facing the municipality. In our base case for 2022-2024, Östersund will sustain an operating balance structurally above 5% of revenue. We expect a rapid but temporary increase in investments within both the municipality and the company sector, sparking funding needs and an increase in debt. However, we believe the municipality's financial management will remain committed to prudent risk practices, with a tight grip on the debt burden and sustained strong liquidity.

The supportive institutional framework and resilient economy counterbalance economic challenges

We consider the institutional framework in Sweden extremely predictable and supportive, demonstrated by our national GDP per capita forecast at about \$61,000 in 2022. Local and regional governments' (LRGs') revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. Furthermore, the central government's swift response to the COVID-19 pandemic, partly through ample distribution of grants to LRGs, supports our view. The central government has backed LRGs throughout the pandemic, implementing both direct and indirect support packages to boost Swedish municipalities' operating performance. Although the Russia-Ukraine conflict will continue to weigh on--directly and indirectly--Swedish LRGs' financial positions, we believe the central government will remain supportive and compensate most of the sector's additional costs, similar to the 2015 European refugee crisis. Although other structural challenges persist and budgetary performance could weaken somewhat as extraordinary support is phased out, we see the risk of a significant deterioration of the sector's financial stability as limited (see "Institutional Framework Assessment: Swedish Municipalities And Counties," published Dec. 13, 2021, on RatingsDirect).

We believe the transition to a new municipal government will not bear fiscal risks. Although we still don't know how Östersund will form a ruling government after the recent local election, we believe the political management will stay committed to disciplined fiscal policies, evidenced by historically broad consensus of the long-term financial goals for the municipality. Östersund is a well-managed and stable municipality with an expanding population and low unemployment. There is a positive trend of employers relocating operations to the city, boosting demand for housing. We do not think cost pressure from increasing energy prices, higher inflation, and demographic challenges will deter management from its steady budgetary discipline and efficiency measures across the municipal boards. Overall, we expect that stronger tax revenue growth will help offset the strain from gradually declining government grants and upcoming cost

pressures.

Debt will likely climb as the company sector ramps up its investments

We expect Östersund to accelerate its capital expenditure (capex) to about Swedish krona (SEK) 700 million on average over the planning period (compared with our estimate of an average of SEK533 million in our April 2022 review). The capex increase primarily points to the previously delayed projects now underway, as well as increasing costs of construction materials, among other items. As such, we anticipate a small average deficit after capital accounts of 4.8% over 2020-2024 with a deficit spike of 11.4% in 2022. The higher capex creates a need for debt funding that triggers a jump in debt ratios over the coming few years. By year-end 2024, we estimate direct debt will be 132% of operating revenue, up from 95% in 2021. We acknowledge that most debt held by the municipality is lent to the company sector, but we continue to use direct debt as a starting point to assess the debt burden. Investments in housing company Östersundshem mostly relate to refurbishments, whereas for energy company Jämtkraft they largely include a new windmill park and a combined heat and power plant.

We assess Östersund's liquidity as strong, based on its solid debt-service coverage ratio, which we estimate at 143% for the coming 12 months. However, we don't believe the ratio will structurally remain at this level, and rather expect the ratio to be volatile given the upcoming maturity profile. In our assessment of liquidity cover ratio, we calculate cash, highly liquid securities and committed facilities as a share of maturing debt and financing needs for investments. Moreover, in line with other rated Swedish LRGs, it has a strong track record of reliable access to external financing.

Key Statistics

Table 1

Municipality of Östersund--Selected Indicators

Mil. SEK	--Fiscal year ends Dec. 31--					
	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenue	5,056	5,272	5,510	5,697	5,965	6,145
Operating expenditure	4,776	4,914	5,060	5,366	5,600	5,793
Operating balance	280	358	450	331	365	352
Operating balance (% of operating revenue)	5.5	6.8	8.2	5.8	6.1	5.7
Capital revenue	92	32	22	0	0	--
Capital expenditure	371	500	705	983	628	520
Balance after capital accounts	1	(110.0)	(234.0)	(651.8)	(263.3)	(167.8)
Balance after capital accounts (% of total revenue)	0.0	(2.1)	(4.2)	(11.4)	(4.4)	(2.7)
Debt repaid	1,400	1,800	1,750	1,900	1,350	1,925
Gross borrowings	1,455	1,800	2,150	3,376	2,113	2,593
Balance after borrowings	81	(90)	(71)	24	0	0
Direct debt (outstanding at year-end)	4,875	4,875	5,225	6,701	7,465	8,132
Direct debt (% of operating revenue)	96.4	92.5	94.8	117.6	125.1	132.3

Table 1

Municipality of Ostersund--Selected Indicators (cont.)

Mil. SEK	--Fiscal year ends Dec. 31--					
	2019	2020	2021	2022bc	2023bc	2024bc
Tax-supported debt (outstanding at year-end)	5,077	5,074	5,420	6,893	7,653	8,318
Tax-supported debt (% of consolidated operating revenue)	43.0	49.6	45.3	59.4	62.5	66.9
Interest (% of operating revenue)	0.2	0.3	0.2	1.4	2.5	2.9
Local GDP per capita (\$)	--	--	--	--	--	--
National GDP per capita (\$)	52,186.7	52,431.1	60,448.6	61,061.1	63,954.9	67,352.6

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. \$--U.S. dollar.

Ratings Score Snapshot

Table 2

Municipality of Ostersund--Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	2
Liquidity	2
Debt burden	3
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, Oct. 10, 2022. 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, July 26, 2022
- Southern Swedish LRGs Bear The Brunt Of Surging Electricity Prices, July 20, 2022
- Sweden, May 2, 2022
- Swedish Local Governments Are Holding Up Against Cyber Attacks, Jan. 26, 2022
- 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

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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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