

Research Update:

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

April 12, 2024

Overview

- Municipality of Östersund's debt accumulation will accelerate as capital expenditure on local infrastructure remains high in the municipal group of companies.
- We expect management will remain committed to maintaining strong operating balances and its liquidity position to mitigate risk from debt accumulation.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Östersund.
- The outlook is stable.

Rating Action

On April 12, 2024, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the Swedish Municipality of Östersund. The outlook is stable.

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

Outlook

The stable outlook reflects our view that Östersund's strong operating balances will mitigate the risk stemming from a forecast increase in debt due to continued high investment levels.

Downside scenario

We could lower the rating if high investment needs in the company group or increasing costs in ongoing projects prevent the deficit after capital accounts from strengthening in line with our expectations. We also consider that higher-than-projected capital spending (capex) could lead to further debt accumulation beyond our base-case assumptions.

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Upside scenario

We could consider a positive rating action if Östersund significantly reduced its debt, underpinned by solid cost control and potentially lower investment levels, all else remaining equal.

Rationale

We expect Östersund's operating performance will gradually strengthen through 2026, after a weaker 2024, supported by lower cost inflation and stronger tax revenue growth. It is our view that this would mitigate risks coming from high investment needs in the municipal group of companies, which will lead to acceleration of debt accumulation. We also think management will remain committed to its financial policies.

An extremely supportive and institutional framework and strong local economy continue to support our ratings on Östersund

We consider the institutional framework in Sweden extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the sector's revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. Historically, the central government has provided extensive support to the local and regional government sector, for example through additional grants distributed in response to the pandemic or more recently to cover rising pension costs (for more information, see "Swedish Municipalities And Regions Have Flexibility To Balance Costs," published Nov. 29, 2023, on RatingsDirect).

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 consider the political and managerial strength in Östersund at par with domestic peers. Management remains committed to fiscal discipline and counteracts pressure on the municipality's financial position, for instance through cost containment measures. Östersund is governed by a majority collaboration between the Social Democrats and the Center Party. We expect that Östersund's management will continue to use prudent debt and liquidity practices as the municipal group is in an investment phase requiring additional debt financing in the coming years. We believe that the municipality will keep a reasonable refinancing risk approach, demonstrated by very strong liquidity coverage of maturing debt.

Östersund's economy is supported by Sweden's comparably high wealth levels, as seen in our estimated 2024 GDP per capita of \$60,000. We expect sound population growth for the municipality, roughly in line with the national average, from about 65,000 in 2023. The local economy is diversified with a wide range of small- and midsize enterprises in various industries. Unemployment, at 4.8% by year-end 2022, is better than the national average, supported by centralization of jobs to Östersund as the city is located far from other similar sized or larger cities.

Capex will remain high in the municipal group of companies leading to an acceleration of debt accumulation in coming years

We expect operating performance to weaken in 2024, coming from an exceptionally strong 2023 owing to a one-off dividend from the municipal owned subsidiaries of Swedish krona (SEK)576 million (€50 million). From 2025 we expect gradual improvement in operating performance

because tax revenue growth will outpace expenditure growth and pension-related costs will ease as a result of lower inflation. We expect Östersund will remain committed to controlling costs to uphold balanced budgets in accrual terms, given that inflation has pressured operating margins in 2023 and 2024. We forecast no further dividends from the municipal companies through 2026 because expected dividends were paid out in a lump sum in 2023. Especially the energy company Jämtkraft will require more onlending in the coming years. The municipality's own capex, primarily related to educational facilities and water and waste infrastructure, normalized at still high levels in 2023 from the all-time high in 2022. Water-related projects are seeing a steep increase in costs, with a water treatment plant originally budgeted at SEK742 million having increased to an expected cost of SEK1.7 billion due to higher safety requirements, local sediment conditions, and high inflation since the project's approval. These added costs are not reflected in our base case currently because the timing of the additional spending is not certain at this time, and we understand that the majority of the extra spending on the water treatment facility will happen from 2027. Although we consider that this could pose a risk of widening deficits after capital accounts for the municipality, we think it is possible that the municipality may take mitigating actions to reduce other capex or strengthen operating performance further.

Among Östersund's companies, we expect Jämtkraft will have significant borrowing needs through 2026. The company has relatively ambitious investment plans requiring debt funding, and we expect it will borrow SEK560 million annually over the next three years. These loans will be sourced through the municipality's in-house bank. Consequently, we expect Östersund's debt will notably increase in the coming years. Like most other Swedish LRGs, the profile of Östersund's debt is short dated from an international perspective. Although the municipality's interest expenditure has increased rapidly, we believe market rates will start to come down later in 2024 and interest expenditure remain below 5% as a share of revenue through 2026. Moreover, about 85% of Östersund's direct debt was onlent to its companies by year end 2023, who are also servicing their own debt. As a result, the negative effect of higher interest payments on the municipality's operating balance is limited because there is a matching increase in payments from the municipal companies for their respective interest costs. We continue to consider the municipality's contingent liabilities, constituting a small amount of extended guarantees, limited.

We regard Östersund's liquidity position as exceptionally strong, stemming from an ample amount of liquidity sources, covering 156% 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 year, and we expect the coverage ratio will remain solid. In our liquidity calculation, we include SEK4.1 billion in cash, financial assets, and back-up facilities. We also include an average of SEK2.3 billion of maturing debt and interest.

Key Statistics

Table 1

Municipality of Östersund--Selected indicators

Mil. SEK	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenue	5,523	5,833	6,926	6,481	6,727	6,947
Operating expenditure	5,098	5,330	5,953	6,153	6,357	6,510
Operating balance	426	503	973	327	371	437
Operating balance (% of operating revenue)	7.7	8.6	14.1	5.1	5.5	6.3
Capital revenue	22	19	24	45	58	29

Table 1

Municipality of Ostersund--Selected indicators (cont.)

Mil. SEK	2021	2022	2023	2024bc	2025bc	2026bc
Capital expenditure	705	1,161	872	792	768	682
Balance after capital accounts	(258)	(639)	126	(420)	(340)	(217)
Balance after capital accounts (% of total revenue)	(4.7)	(10.9)	1.8	(6.4)	(5.0)	(3.1)
Debt repaid	1,750	1,900	1,700	2,375	2,250	2,300
Gross borrowings	2,150	3,120	3,350	3,500	3,150	3,000
Balance after borrowings	(71)	(26)	(165)	(95)	(5)	(7)
Direct debt (outstanding at year-end)	5,225	6,445	8,095	9,220	10,120	10,820
Direct debt (% of operating revenue)	94.6	110.5	116.9	142.3	150.4	155.8
Tax-supported debt (outstanding at year-end)	5,420	6,635	8,282	9,411	10,310	11,010
Tax-supported debt (% of consolidated operating revenue)	45.3	40.7	51.6	59.6	64.3	67.7
Interest (% of operating revenue)	1.0	1.3	4.1	4.7	4.7	4.5
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	528,606	571,313	598,264	608,711	628,917	648,518

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	1
Debt burden	4
Stand-alone credit profile	aa+

Key Sovereign Statistics

Sovereign Risk Indicators, Dec. 11, 2023. An interactive version is available at <http://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

- Subnational Debt 2024: Focus On Debt Sustainability, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Subnational Debt 2024: Global LRGs Can Handle Rising Interest Expenses, Feb. 29, 2024
- Institutional Framework Assessment: Swedish Municipalities And Regions Have Flexibility To Balance Costs, Nov. 29, 2023
- Sweden's Local And Regional Governments Have Less Room To Maneuver Over The Next Year As Pension Costs Rise, Sept. 14, 2023

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

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Ratings Affirmed

Ostersund (Municipality of)

Issuer Credit Rating	AA+/Stable/A-1+
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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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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