

Research Update:

# Swedish Municipality of Sodertälje Ratings Affirmed At 'AA+/A-1+'; Outlook Stable

June 2, 2023

## Overview

- We expect the Municipality of Södertälje to maintain prudent financial management and sustain strong cash-flow-based budgetary performance in the coming years.
- After several years of decreasing debt levels, we expect debt will increase modestly through 2025 due to higher capital expenditure.
- Södertälje's liquidity position remains very strong, supported by recent increases in its credit facilities.
- We therefore affirmed our 'AA+/A-1+' long- and short-term issuer credit ratings on Södertälje, as well as our 'K-1' Nordic regional scale rating. The outlook is stable.

## Rating Action

On June 2, 2023, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the Municipality of Södertälje. The outlook is stable.

We also affirmed our 'K-1' Nordic regional scale rating on Södertälje.

## Outlook

The stable outlook reflects our view that risks related to weaker macroeconomic fundamentals are balanced by the strong track record of Södertälje's financial management. Measured in cash terms, we expect resilient operating surpluses and minor deficits after capital accounts.

## Downside scenario

We could take a negative rating action if Södertälje's management fails to adequately address local socio-economic pressures and other, sector-wide challenges. This could result in recurring, more pronounced deficits and its debt burden rising more than currently anticipated.

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## Upside scenario

We could raise the rating if active policy, both at the local and central government levels, reduces the socio-economic pressure on Södertälje's finances. The municipality's creditworthiness could also improve if it can significantly reduce its debt burden. This could stem from improved fiscal discipline, with stricter cost controls translating into markedly lower deficits after capital accounts than incorporated in our base case.

## Rationale

Our affirmation of the ratings on Södertälje is supported by the expectation that its cash-flow-based operating performance will remain robust through 2025. Inflationary pressure, higher pensions costs, and socio-demographic cost pressure will be counterbalanced by sound tax revenue growth, while rising interest costs on the portion of debt Södertälje has on-lent to municipal government-related entities (GREs) will be reimbursed. However, we expect the municipality's investments to drive a gradually expanding debt burden through 2025.

## Financial management remains among the strongest in the peer group while the municipality benefits from broad cross-block consensus on core political issues

We expect Södertälje's management will remain committed to confronting structural challenges and undertake necessary efficiency measures to comply with its balanced budget requirement. Since elections in September 2022, Södertälje has been governed by a majority coalition consisting of parties from both sides of the traditional left-right blocks. Despite a somewhat lengthy period to form a government, we have historically observed strong consensus regarding long-term strategies and priorities. We continue to view the collaboration between politicians and civil servants as efficient, adding to the predictability of Södertälje's financial position and supporting budgetary discipline. Although expenditure-related deficiencies within some municipal boards have at times weighed negatively on its performance, we observe that Södertälje is generally very prudent with regards to reporting and promptly addressing any negative deviations from the budget. Södertälje's management has a very proactive and successful track record of addressing local socio-economic issues. We also note that, contrary to most peers, it has reduced the municipality's debt burden materially over the past few years.

We regard the institutional framework in Sweden as extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the sector's revenue and expenditure management benefits from a far-reaching equalization system and local tax autonomy. Furthermore, the central government's swift response to the COVID-19 pandemic, partly through the distribution of general grants to the sector, supports our view.

Södertälje benefits from Sweden's strong wealth levels, as illustrated by our 2023 national GDP per capita estimate of about \$58,000, but faces distinct local socio-economic challenges. The municipality has a large labor market with world-leading companies in the auto and pharmaceutical sectors, such as Scania and AstraZeneca, resulting in a net positive commuter flow into the municipality. However, due to a demographic-related mismatch in the job market, Södertälje has a markedly weaker unemployment rate compared to national and regional levels. The local rate stood at 10.9% by year-end 2022, compared with a national average of 7.5%. Furthermore, we have observed more widespread instances of violence in the municipality. We

believe that such socioeconomic characteristics still translate into higher spending pressure and lower tax revenue, thereby weighing on our assessment of the local economy. Nonetheless, the institutional framework in Sweden and the very strong financial management in Södertälje provide a cushion and remain key components of the municipality's strong creditworthiness.

### **Strong tax revenue growth and interest reimbursement for on-lent debt will mitigate pressure on operating performance from higher inflation and yields**

We expect 2023 will be a challenging year for the Swedish local and regional government (LRG) sector, amid rising interest costs, inflationary pressure, structural demographic issues, and slower tax revenue growth. Consequently, we forecast Södertälje's operating balance will fall to 5.7% in 2023 from 7.3% in 2022. That said, we positively assess that our base-case projections point to operating balances above 5% through 2025. Regarding exposure to higher interest rates, we note that Södertälje will be partially reimbursed for rising interest costs by its municipal-owned GREs, to which it has on-lent a large portion of its debt.

In 2023-2024, the Swedish LRG sector's performance, including Södertälje's, will be burdened by significantly larger pension costs. This is due to a new pension agreement from January 2023, which includes a larger contribution to employees (6.0% instead of 4.5%) and a negative cash-flow effect compared to the old agreement. Furthermore, a second effect comes from the existing pension liability being consumer price index linked, which forces Swedish LRGs to increase pension provisions. However, this part is a noncash expense that does not affect S&P Global Ratings' calculation of the operating balance. Overall, on an accrual basis, the increase in pension costs will have notable effects on Swedish LRGs' income statements. Moreover, since a share of the pension-related expenditure increase does not affect cash outflows, while LRGs adjust their budgets to accommodate the full accrual-based impact, it does not have a significant net effect on our calculated budgetary performance ratios. For Södertälje, this is most pronounced in 2023, after which the effect on budgetary performance is substantially smaller.

For 2024-2025 we expect a slightly strengthening trend in operating performance, with operating balances averaging about 5.8% over the two years. This will be driven by an expected deceleration in inflation and stable tax-revenue growth. Furthermore, we anticipate management will remain committed to implementing efficiency measures, especially to address structural deficits at a few municipal boards. Overall, we forecast relatively stable operating results in the coming years and that Södertälje will comply with Sweden's accrual-based balanced budget requirement.

We forecast sizeable and increasing capital expenditure (capex) over the coming years will result in small deficits after capital accounts through 2025. However, due to additional on-lending, we expect a larger increase in outstanding debt. Potential delays in Södertälje's and its companies' capex programs and solid cash flow will likely mitigate the debt build-up. We continue to consolidate the capex of Södertälje's official-use property company, Telge Fastigheter AB, with the municipality's own investments, since we consider this company an integral part of operations. Notable investment needs through 2025 in the rest of the municipal company sector, particularly the public housing and utility companies, are not captured in Södertälje's own after-capex performance. However, being funded through on-lending by the municipality's in-house bank, they will be reflected in the municipality's higher outstanding debt volumes. One of the main recipients of Södertälje's on-lending is its financially strong housing company Telge Bostäder AB. Although this does not improve our assessment of Södertälje's debt, we consider it a mitigating factor that a significant share has been on-lent to this company. We continue to view Södertälje's other contingent liabilities, including guarantees extended to public sector funding agency Kommuninvest, as limited.

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Södertälje's very strong liquidity position is supported by ample reserves, including contracted credit facilities. We estimate the debt service coverage ratio at 182%. The municipality's contracted facilities have expanded by Swedish krona (SEK) 1.2 billion, to total SEK4 billion. Management intends to maintain a lower, or even no, share of commercial paper. This could result in lower debt repayments and stronger coverage ratios, thereby translating into a more favorable liquidity position. In line with other rated Swedish LRGs, we view Södertälje's access to external liquidity as strong, with sources of financing readily available.

Södertälje has centralized its treasury activities to the in-house bank. In our view, the treasury adheres to conservative, risk-minimizing policies, and ensures cost-efficient financing for the municipality and its GREs. The main source of funding is the capital market, via the municipality's SEK10 billion medium-term note program. It also has a SEK4 billion commercial paper program and borrowings via Kommuninvest. Södertälje has prolonged its debt maturity profile over the past few years, leading to less refinancing risk and lower pressure on the liquidity position.

## Key Statistics

Table 1

### Södertälje (Municipality of) Selected Indicators

Mil. SEK	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenues	7,404	7,719	8,245	8,591	8,894	9,260
Operating expenditures	7,007	7,128	7,643	8,100	8,382	8,724
Operating balance	397	591	602	491	511	536
Operating balance (% of operating revenues)	5.4	7.7	7.3	5.7	5.7	5.8
Capital revenues	155	111	91	60	50	318
Capital expenditures	251	318	555	691	746	908
Balance after capital accounts	301	384	138	(140)	(185)	(54)
Balance after capital accounts (% of total revenues)	4.0	4.9	1.7	(1.6)	(2.1)	(0.6)
Debt repaid	2,407	2,255	1,673	2,150	1,900	1,050
Gross borrowings	1,758	2,246	2,547	2,833	2,614	1,487
Balance after borrowings	157	(9)	218	(248)	0	0
Direct debt (outstanding at year-end)	7,374	7,365	8,239	8,922	9,635	10,072
Direct debt (% of operating revenues)	99.6	95.4	99.9	103.8	108.3	108.8
Tax-supported debt (outstanding at year-end)	7,374	7,365	8,239	8,922	9,635	10,072
Tax-supported debt (% of consolidated operating revenues)	74.1	70.4	75.5	78.3	81.9	82.5
Interest (% of operating revenues)	1.7	2.0	3.0	3.3	3.9	4.9
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A

Table 1

**Sodertalje (Municipality of) Selected Indicators (cont.)**

Mil. SEK	2020	2021	2022	2023bc	2024bc	2025bc
National GDP per capita (single units)	487,872	526,244	566,987	598,376	622,440	642,470

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

**Sodertalje (Municipality of) Ratings Score Snapshot**

Key rating factors	Scores
Institutional framework	1
Economy	2
Financial management	1
Budgetary performance	2
Liquidity	1
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**

- Sweden, May 1, 2023

**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 Local And Regional Governments Outside Of The U.S., March 22, 2023
- 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

#### Sodertalje (Municipality of)

Issuer Credit Rating	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AA+
Commercial Paper	K-1

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