S&P Global
Ratings

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Research Update:

Swedish Municipality Of Orebro Outlook Revised To Stable From Negative; 'AA+/A-1+' And 'K-1' Ratings Affirmed

April 2, 2021

Overview

- We expect Örebro will post relatively stable operating results through 2023 and comply with the balanced budget requirement on the back of continued central government support and gradually stronger tax revenue growth.
- Moreover, likely stronger cash flows combined with an extended debt maturity profile will translate into improved liquidity coverage ratios.
- We therefore revised our outlook on Örebro to stable from negative and affirmed our 'AA+/A-1+' and 'K-1' ratings.

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Rating Action

On April 2, 2021, S&P Global Ratings revised its outlook on the Swedish municipality of Örebro to stable from negative, and affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings. At the same time, we affirmed our 'K-1' Nordic regional scale rating on the municipality.

Outlook

The stable outlook reflects our view that Örebro will maintain a relatively steady operating performance through 2023, despite the lingering economic effects of COVID-19, gradually diminishing government grants, and demographic challenges. Consequently, we expect the municipality will comply with the balanced budget requirement. In addition, we expect the municipality will maintain a strong liquidity position, supported by an extended debt maturity profile and stable annual debt repayments.

Downside scenario

We could take a negative rating action if Örebro fails to adequately address the impact of the pandemic and sectorwide challenges, including demographic issues, resulting in recurring deficits and a weaker liquidity position. In such a scenario, we could also consider reassessing our view of the municipality's management. Furthermore, we could take a negative rating action if medium-term systemic support to the local and regional government (LRG) sector proves insufficient.

Upside scenario

We could consider an upgrade if Örebro's management contained operating spending, leading to structural operating surpluses exceeding 5% of revenue. In this scenario, we would also expect stricter debt policies, which, in combination with stronger cash flow generation, would lead to a much lower debt burden.

Rationale

We revised our outlook to stable from negative since we now forecast an improvement in Örebro's operating performance, supported by extensive central government support and gradually improved tax revenue growth. Consequently, we expect Örebro can comply with the central government's balanced budget requirement through 2023. Furthermore, our expectation of stronger cash flows, combined with the municipality's intention to extend its debt maturity profile, translates into a stronger liquidity position.

The central government has provided unprecedented support to the LRG sector during the pandemic but structural issues remain unresolved

We consider the institutional framework in Sweden to be extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the LRG sector's revenue and expenditure management is based on a far-reaching equalization system and tax autonomy. The central government's swift response to the pandemic, partly through the distribution of general grants to the sector, further supports our view.

However, before the outbreak of COVID-19, the sector's budgetary performance had structurally deteriorated due to increasing expenditure, accentuated by central government policymaking, insufficient compensation mechanisms, and LRGs' inadequate countermeasures. Furthermore, how the central government aims to address the sector's demographic challenges, and to what extent it should provide financial support, are unclear. Consequently, we assess the institutional framework trend as weakening.

The political situation in Örebro remains relatively stable, despite the minority government. Since the elections in 2018, the three-party ruling coalition has been supported by the Left Party. We do not foresee any major financial policy shifts in the medium term, since the municipality will continue addressing deficits in struggling municipal boards and demographic challenges. In our view, Örebro's budgetary control is in line with that of comparable Swedish peers. In the coming years, we expect management will remain committed to budgetary discipline and undertake necessary efficiency measures to comply with the balanced budget requirement.

Örebro is a regional growth center, with a dynamic and well-diversified local economy. Unemployment rates and income levels are roughly in line with national averages. Örebro also benefits from Sweden's wealthy economy, reflected in our national GDP per capita estimate of about $59,700 in 2021.

Additional central government support and higher tax revenue will boost budgetary performance and strengthen Örebro's liquidity position

As a result of extensive central government support and gradually stronger tax revenue growth, we expect Örebro's budgetary performance will remain relatively stable through 2023. Since COVID-19 started spreading in Sweden, the central government has distributed unprecedented general grants to the LRG sector. It has also provided extensive support to the private sector through employment schemes, thereby shielding tax revenue growth. The municipality's expenditure was also lower than expected, partly due to cancelled activities in light of the pandemic. As a result of these factors, Örebro will post abnormally high operating results for 2020.

For 2021-2023, we expect the gradual decline in government support and lingering effects from COVID-19 to result in weaker operating performance. In addition, Sweden's demographic challenges, partly characterized by an aging population, will continue to pressure Örebro in the coming years. However, the additional support announced by the central government as a part of the 2021 Budget Bill will counterbalance this pressure. Furthermore, we expect 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 Örebro will comply with Sweden's accrual-based balanced budget requirement.

We forecast somewhat lower capital expenditure through 2023 than in 2019-2020. However, we expect investment needs at municipal companies will remain elevated over the next two to three years, mainly the housing company, Örebrobostäder AB. We continue to view onlending to the housing company as a mitigant to our overall assessment of Örebro's debt. The company's financial profile is strong, underpinned by stable noncyclical operating cash flows on the back of high demand for rental housing in the city of Örebro. The company has substantial surplus values in its property portfolio and the loan-to-value ratio was 22% at year-end 2020. Adjusting for onlending to this entity, Örebro's direct debt falls to 76% of operating revenue from 146%. Furthermore, we regard the municipality's contingent liabilities, including its joint and several guarantee to Kommuninvest, as limited and the risk of materialization as low.

Debt and liquidity management are centralized and managed via the inhouse bank, which is responsible for the funding needs of the municipality and its companies. The funding sources are diversified and include capital market borrowings via a Swedish krona (SEK) 8 billion (about $921 million) medium-term note program, a SEK5 billion commercial paper program, and borrowings from Kommuninvest and the Nordic Investment Bank.

Örebro's liquidity position remains strong, supported by ample reserves of cash holdings, financial assets, and committed facilities. We estimate the weighted debt-service coverage ratio at 156%. Owing to the strong cash flows generated from extraordinary grants last year, the municipality's cash position was abnormally strong at the end of 2020. We expect Örebro's cash holdings will revert to more normal levels during 2021. Furthermore, we apply haircuts to the municipality's financial assets based on the underlying credit quality of the security. In terms of debt composition, we expect Örebro will reduce the amount of outstanding commercial paper and prioritize contracting long-term funding. Overall, we expect relatively stable debt repayments through 2023. Consequently, we expect the debt coverage ratio will remain strong in the coming years at comfortably above 120%. Furthermore, in line with other LRGs we rate in Sweden, we believe Örebro benefits from strong and reliable access to external liquidity, even in times of financial stress.

Key Statistics

Table 1

Municipality of Orebro Selected Indicators

	--Fiscal year-end Dec. 31--					
Mil. SEK	**2018**	**2019**	**2020e**	**2021bc**	**2022bc**	**2023bc**
Operating revenues	11,095	11,603	11,976	12,217	12,496	12,815
Operating expenditures	10,708	11,299	11,361	11,727	12,053	12,363
Operating balance	387	304	615	490	444	452
Operating balance (% of operating revenues)	3.5	2.6	5.1	4.0	3.6	3.5
Capital revenues	217	520	258	150	150	150
Capital expenditures	1,091	1,005	881	707	598	787
Balance after capital accounts	(487)	(182)	(8)	(67)	(4)	(185)
Balance after capital accounts (% of total revenues)	(4.3)	(1.5)	(0.1)	(0.5)	0	(1.4)
Debt repaid	3,151	4,558	5,513	4,400	4,150	4,200
Gross borrowings	4,349	4,758	6,355	5,051	5,092	5,430
Balance after borrowings	(357)	(49)	0	(146)	0	0
Direct debt (outstanding at year-end)	14,812	15,008	15,850	16,501	17,443	18,673
Direct debt (% of operating revenues)	133.5	129.3	132.3	135.1	139.6	145.7
Tax-supported debt (outstanding at year-end)	15,561	15,747	16,586	17,237	18,180	19,410
Tax-supported debt (% of consolidated operating revenues)	114.3	111.4	114.7	116.9	120.6	125.7
Interest (% of operating revenues)	2.5	2.1	2.2	2.2	2.1	2.1
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	477,094	491,200	479,449	497,941	518,171	537,124

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 Orebro Ratings Score Snapshot

Key rating factors	Score
Institutional framework	1

Table 2

Municipality of Orebro Ratings Score Snapshot (cont.)

Key rating factors	Score
Economy	1
Financial management	2
Budgetary perfomance	3
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 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 12, 2021

Related Criteria

- 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, Feb. 8, 2021
- Sovereign Risk Indicators, Dec. 14, 2020. An interactive version is available at www.spglobal.com/sri
- Extra Funding In Sweden's 2021 Budget Will Support LRGs, Sept. 24, 2020
- European Local And Regional Government Risk Indicators, June 30, 2020

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; Outlook Action	To	From
Orebro (Municipality of)		
Issuer Credit Rating	AA+/Stable/A-1+	AA+/Negative/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. 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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