Research Update:

Municipality Of Orebro 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

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Overview

- We expect the Swedish municipality of Örebro's operating performance will normalize over the coming two years as COVID-19-related support is phased out and expenditure increases on higher demand for welfare services.
- As lower population growth reduces investment needs in educational facilities, we now forecast Örebro will generate a surplus after capital accounts through 2024.
- That said, we continue to assess Örebro's relative debt burden as one of the highest among domestically rated peers, although mitigated by the majority being on-lent to financially strong subsidiaries.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Örebro. The outlook is stable.

Rating Action

On April 1, 2022, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term global scale issuer credit ratings on the Swedish municipality of Örebro. The outlook is stable.

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

Outlook

The stable outlook reflects our view that Örebro will balance cost pressures and uphold stable, yet gradually weakening, operating performance through 2024. We expect Örebro's debt burden will increase notably to fund company-sector investments.

Downside scenario

We could consider a negative rating action if Örebro fails to contain expenditure stemming from, for instance, demographic challenges or economic-related risks, leading to recurring and notable deficits after capital accounts and a weaker liquidity position. In such a scenario, we could also

consider reassessing our view of the municipality's management.

Upside scenario

We could consider an upgrade if Örebro's management implemented more conservative debt policies, resulting in a marked reduction of the municipality's debt burden, including on-lent debt to its subsidiaries, to below 120% of operating revenue.

Rationale

We expect Örebro will post stable, albeit gradually weakening, operating performance through 2024. This will result from diminishing central government grants and higher expenditure growth caused by a return to more normal demand for municipal services as the pandemic abates. Given slower population growth than we estimated, we now expect lower investment in educational facilities. As a result, we now forecast Örebro will post surpluses after capital accounts (including borrowings of the fully owned school property company Futurum Fastigheter AB). That said, investments among other subsidiaries will remain high, requiring debt funding.

The supportive framework for Swedish local and regional governments balances the sector's structural challenges

Since December 2021, we assess Sweden's institutional framework trend as stable, compared to weakening previously. We continue to regard it as 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.

Since the outbreak of COVID-19, the central government has remained supportive of the local and regional government (LRG) sector, implementing both direct and indirect support packages to boost operating performance for Swedish municipalities. Although structural challenges remain and budgetary performance could weaken somewhat as extraordinary support is phased out, we regard the risk of a significant deterioration of the sector's financial stability as limited.

Örebro is governed by a Social Democratic-led minority coalition that benefits from passive support from the Left Party. We regard the situation as stable and have observed consensus regarding long-term strategies. In our view, Örebro's budgetary control is in line with that of comparable Swedish peers. We expect management will remain committed to budgetary discipline and undertake necessary measures to comply with the balanced budget requirement. Örebro's debt and liquidity management is centralized through the inhouse bank, which is responsible for the funding needs of the municipality and its companies. In our view, the treasury adheres to prudent financial policies.

Örebro benefits from Sweden's high wealth levels and strong economic fundamentals, reflected in our estimate of 2022 national GDP per capita at about $61,100. 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.

Reduced investments in educational facilities will turn the after capital accounts balance to a surplus, despite a normalization of operating performance

We forecast Örebro's operating performance will gradually weaken below 5% of operating revenue through our forecast period, compared to the strong level seen in 2020 and 2021 in excess of 5%. Although we believe tax-revenue growth will continue to support Örebro's performance, we expect that the phased-out pandemic support, provided by the central government, will impair margins. We also expect higher expenditure growth from higher demand for welfare services as pandemic restrictions are lifted, but also from higher inflation and energy prices.

Moreover, in contrast to previous reviews, we now forecast Örebro will post surpluses after capital accounts, since we expect lower investments related to the school property company Futurum. The company has completed a large refurbishment program at the same time as the need for new construction diminished, due to lower expected population growth for the coming decade. Consequently, we do not forecast Futurum will borrow through 2024, which strengthens Örebro's after capital accounts balance.

Although we think the Russia-Ukraine conflict could have a meaningful impact on Swedish LRGs' revenue and expenditure through our forecast period, we believe the central government will remain supportive and compensate most of the sector's additional costs, similar to the 2015 European refugee crisis. However, we acknowledge that should the crisis turn into notable immigration to Örebro, it could spur additional capital spending and result in deficits after capital accounts for the municipality.

Furthermore, we expect investment among the municipal companies will remain high through 2024, mainly related to the housing company, Örebrobostäder AB, which in addition to new construction also has relatively large upcoming refurbishment investments. We forecast the companies will borrow Swedish krona (SEK) 1.3 billion (about $137 million) annually through 2024, which will be on-lent through the inhouse bank, setting Örebro's direct debt on an upward trajectory.

We continue to view on-lending 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. Adjusting for on-lending to this entity, Örebro's direct debt falls to 75% of operating revenue. We continue to regard the municipality's contingent liabilities, including its joint and several guarantee to Kommuninvest, as limited. We expect a modest increase in extended guarantees over the coming years, since we understand the partly owned water company Vätternvatten AB will borrow externally supported by municipal guarantees.

Örebro's liquidity position remains solid, and we estimate the weighted debt-service coverage ratio at 178% as of March 2022. Although we expect a somewhat weaker coverage ratio, as operating performance normalizes compared to the past two years, we expect Örebro will remain comfortably above the 120% threshold.

The liquidity position is supported by ample reserves of cash holdings, financial assets (to which we applied haircuts based on the underlying credit quality of the security), committed facilities, and strong access to external liquidity. Örebro's funding sources are diversified through a SEK12 billion medium-term note program, a SEK5.0 billion commercial paper program, and borrowings from Kommuninvest and the Nordic Investment Bank. We expect Örebro will maintain its relative share of commercial paper as part of the debt portfolio, prioritizing contracting long-term funding.

Overall, we expect relatively stable debt repayments through 2024.

Key Statistics

Table 1

Municipality of Orebro Selected Indicators

	--Fiscal year-end Dec. 31--					
(Mil. SEK)	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenues	11,603	11,976	12,367	12,677	13,026	13,356
Operating expenditures	11,299	11,361	11,391	11,975	12,439	12,762
Operating balance	304	615	976	702	587	594
Operating balance (% of operating revenues)	2.6	5.1	7.9	5.5	4.5	4.4
Capital revenues	520	258	196	240	200	200
Capital expenditures	1,005	881	917	808	751	753
Balance after capital accounts	(182)	(8)	255	134	36	41
Balance after capital accounts (% of total revenues)	(1.5)	(0.1)	2.0	1.0	0.3	0.3
Debt repaid	4,558	5,513	4,400	4,237	4,414	4,307
Gross borrowings	4,758	6,355	5,450	5,307	5,734	5,518
Balance after borrowings	(49)	0	55	(200)	(4)	3
Direct debt (outstanding at year-end)	15,008	15,850	16,900	17,970	19,290	20,500
Direct debt (% of operating revenues)	129.3	132.3	136.7	141.8	148.1	153.5
Tax-supported debt (outstanding at year-end)	15,747	16,597	17,630	18,743	20,099	21,358
Tax-supported debt (% of consolidated operating revenues)	111.4	114.8	118.7	123.3	128.8	133.7
Interest (% of operating revenues)	2.1	2.2	2.0	2.1	2.3	2.5
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	493,600	482,907	518,461	553,766	572,396	589,335

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.

Ratings Score Snapshot

Table 2

Municipality of Orebro Ratings Score Snapshot

Key rating factors	
Institutional framework	1
Economy	1

Table 2

Municipality of Orebro Ratings Score Snapshot (cont.)

Financial management	2
Budgetary perfomance	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, Feb. 7, 2022

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 Assessment: Swedish Municipalities And Counties, Dec. 13, 2021
- Swedish Local Governments Are Holding Up Against Cyber Attacks, Jan. 26, 2022
- Sovereign Risk Indicators, Dec. 13, 2021. An interactive version is available at www.spglobal.com/sri

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	
Orebro (Municipality of)	
Issuer Credit Rating	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1