

Research Update:

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

March 15, 2024

Overview

- We expect the Municipality of Sundsvall's budgetary performance will remain robust through 2026 on the back of strong tax revenue growth and lower cost inflation.
- We expect management will remain committed to its comprehensive and risk-minimizing financial policies, which support the municipality's strong liquidity position.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Sundsvall. The outlook is stable.

Rating Action

On March 15, 2024, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the Swedish Municipality of Sundsvall. The outlook is stable.

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

Outlook

The stable outlook reflects our expectation that Sundsvall will post stable operating results through 2026, supported by robust tax revenue growth, less inflation cost pressure, and continued cost control. Furthermore, we expect Sundsvall will contain debt accumulation, which is mitigated by substantial on-lending to financially stable companies. At the same time, we expect the municipality's financial management will remain committed to maintaining the strong liquidity position.

Downside scenario

We could lower the rating if Sundsvall's management fails to contain operating spending, leading to structural breaches of the balanced budget requirement and debt buildup beyond our base-case expectations.

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Upside scenario

We could raise the rating in the case of a considerable reduction in debt, which could potentially come from asset sales.

An upgrade could also materialize if Sundsvall strengthened its budgetary performance even further and posted structural surpluses after capital accounts.

Rationale

We expect Sundsvall's operating performance will gradually strengthen through 2026, after a weaker 2024. This will come from a combination of lower cost inflation and stronger tax revenue growth as macroeconomic fundamentals improve. At the same time, we expect Sundsvall's management will remain committed to budgetary discipline and implement efficiency measures if needed to meet financial targets. Furthermore, because of investment needs for the municipality and the company sector, we project a gradually expanding nominal debt burden through 2026. However, we assume Sundsvall will remain committed to its financial policies, which also supports the municipality's strong liquidity position. In addition, a significant share of the in-house bank's debt has been on-lent to financially strong companies.

An extremely supportive institutional framework continues to support Sundsvall's credit quality

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 (LRG) 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).

Sundsvall is governed by a majority coalition consisting of three parties from both traditional political blocks in Sweden: The Social Democratic Party, the Centre Party, and the Left Party. Overall, there is widespread consensus regarding the municipality's key priorities and we view the political landscape as stable. Since Sundsvall posted negative balanced budget results in both 2018 and 2019, the municipality's management has successfully implemented efficiency and governance measures to address structural deficits in a few budgetary units. Overall, we believe cost control in the municipality has improved in recent years. Moreover, we believe Sundsvall displays sound debt and liquidity management, supported by a strong track record of maintaining a strong debt service coverage ratio.

Sundsvall's economic landscape has become more diversified in recent decades and the municipality now hosts a wide range of businesses. At the end of 2023, the municipality inaugurated a new logistics park on the Baltic Sea coast, a project that has been administered by the fully owned company Sundsvall Logistikpark AB. The construction of the park will boost trade to and from the Sundsvall region while promoting sustainable transport solutions. Moreover, the municipality's unemployment rate and income levels are roughly at par with national averages, and the socioeconomic profile does not stand out in a domestic comparison. That said, the population has declined, albeit marginally, a few years in a row. In the medium- to long-term, we expect population growth will be limited. Still, Sundsvall benefits from Sweden's strong economic

position, demonstrated by our national GDP per capita forecast of about \$57,600 in 2024.

Budgetary performance will remain robust through 2026, but nominal debt continues to increase

Against the backdrop of strong operating performance in recent years, we expect Sundsvall's budgetary performance will gradually strengthen through 2026, after a somewhat weaker 2024. In 2023, inflationary pressure resulted in higher expenditure growth than expected when the budget was announced. On the other hand, the labor market in Sweden remained robust, translating into stronger tax revenue growth than anticipated.

In 2024, we expect cost inflation will continue to put pressure on Sundsvall's budgetary performance. A new pension agreement will impair operating results in the Swedish LRG sector. In addition, more importantly, annual pension provisions will increase since these are indexed to inflation. Based on our inflation projections, we expect these provisions will remain elevated in 2024. However, these provisions do not generate cash outflows, meaning our calculated performance metrics are not affected (see "Sweden's Local And Regional Governments Have Less Room To Maneuver Over The Next Year As Pension Costs Rise," published Sept. 14, 2023). Despite the significant accrual-based impact of higher pension costs, we expect Sundsvall will post a slightly positive budget result in 2024.

For 2025-2026, we expect Sundsvall's performance metrics will gradually improve as cost pressure abates and tax revenue growth strengthens in line with the macroeconomic environment. Moreover, we expect management will remain committed to budgetary discipline and adhere to the municipality's financial targets. Consequently, we now expect Sundsvall's operating balances will stabilize above 5% of operating revenue in the coming years.

At the end of January 2024, Sundsvall bought three properties, for a value of about Swedish krona (SEK)272 million (about €24 million). The acquisition is in line with the municipality's long-term strategy to own rather than rent most of its properties. Consequently, we expect capital expenditure will be elevated in 2024. In 2025-2026, we expect lower investments, translating into more moderate funding gaps.

Sundsvall's debt and liquidity management is centralized with the in-house bank, which is responsible for the municipality's and the companies' funding needs. Because of investment needs at the municipality and on-lending to municipal companies to finance their investments, we forecast a steady, albeit moderate, increase in Sundsvall's nominal debt burden through our 2024-2026 forecast period. That said, we expect debt as a share of operating revenue will remain roughly unchanged at about 130%.

In the company sector, the main drivers of on-lending will be housing company Mitthem AB and in particular the water company Sundsvall Vatten AB. However, since both companies have strong financial profiles and operate in low-risk industries, we consider the on-lending to these entities as a mitigant to the municipality's debt burden. If we adjust for the on-lending to these companies, the direct debt ratio falls to 87%. Furthermore, we consider Sundsvall's exposure to contingent liabilities as limited and the risk of materialization as low.

As a result of higher interest rates, we expect Sundsvall will post elevated interest expenses through 2026. That said, we expect the interest rate on new borrowings will gradually decrease over the same period. Moreover, given that Sundsvall has on-lent a significant portion of its debt to the company sector--about 72% as of year-end 2023--a part of these expenses will be channeled through to the municipal companies and reflected in higher financial revenue, easing the impact on the municipality's budgetary performance.

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We view Sundsvall's liquidity position as strong, supported by ample amounts of cash holdings, checking accounts, and contracted facilities, and we estimate the weighted debt service coverage ratio at 144%. Through 2026, we expect the liquidity ratio will strengthen further on the back of lower debt repayments. At the same time, the municipality has a strong record of contracting additional facilities to accommodate an expanding debt burden. Moreover, Sundsvall has a history of reliable access to external financing, even in times of financial distress. The municipality's funding options primarily include a SEK12 billion medium-term note program and a SEK3 billion commercial paper program. In recent years, Sundsvall has also increased its share of borrowings in Norwegian krone, which made up about 15% of total debt as of year-end 2023.

Key Statistics

Table 1

Sundsvall (Municipality of)--Selected indicators

Mil. SEK	--Year ended Dec. 31--					
	2021	2022	2023e	2024bc	2025bc	2026bc
Operating revenues	7,999	8,369	8,741	8,942	9,295	9,615
Operating expenditures	7,397	7,427	8,166	8,473	8,754	9,038
Operating balance	602	942	575	469	540	577
Operating balance (% of operating revenues)	7.5	11.3	6.6	5.2	5.8	6.0
Capital revenues	83	114	170	50	50	50
Capital expenditures	582	713	836	954	727	654
Balance after capital accounts	103	343	(91)	(435)	(137)	(27)
Balance after capital accounts (% of total revenues)	1.3	4.0	(1.0)	(4.8)	(1.5)	(0.3)
Debt repaid	2,550	2,750	3,250	3,409	3,150	2,950
Gross borrowings	3,137	3,093	4,054	3,993	3,553	3,144
Balance after borrowings	81	59	104	(239)	0	0
Direct debt (outstanding at year-end)	10,145	10,489	11,293	11,877	12,280	12,474
Direct debt (% of operating revenues)	126.8	125.3	129.2	132.8	132.1	129.7
Tax-supported debt (outstanding at year-end)	10,181	10,522	11,326	11,910	12,312	12,507
Tax-supported debt (% of consolidated operating revenues)	101.9	100.5	104.0	107.0	106.8	105.2
Interest (% of operating revenues)	0.6	0.9	2.3	2.9	3.3	3.9
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	572,067	596,359	607,603	625,921	643,526

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.

Ratings Score Snapshot

Table 2

Sundsvall (Municipality of)--Ratings score snapshot

Key rating factors

Institutional framework	1
Economy	1
Financial management	2
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

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

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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

Sundsvall (Municipality of)

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