

Research Update:

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

March 20, 2020

## Overview

- Sundsvall reported budget deficits against the Swedish regulator's balanced budget requirement in both 2018 and 2019.
- We anticipate Sundsvall's cost-saving measures and additional support from central government will help the municipality balance its budget in 2020.
- We also expect Sundsvall to liquidate its 50% share in Kommungaranti Skandinavien Försäkrings AB, the municipality's part-owned insurance company, in 2020, which should limit debt growth.
- We are affirming our 'AA+/A-1+' and 'K-1' ratings on Sundsvall.
- The outlook is stable.

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## Rating Action

On March 20, 2020, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on the Swedish municipality of Sundsvall. The outlook is stable.

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

## Outlook

The stable outlook reflects our expectation that Sundsvall will successfully implement its cost-saving measures and receive central government support to mitigate any economic and financial impact from the coronavirus epidemic.

## Downside scenario

We could lower the rating if Sundsvall's operating balance weakened further, as a result of escalating cost inefficiencies or weaker economic conditions, resulting in persistent deficits against regulatory requirements. We could also lower the ratings if systemic support to the sector

was insufficient, or if the cost of investments rose beyond our expectations, causing the city's liquidity position to worsen.

## **Upside scenario**

We could raise the rating if management successfully implemented substantial improvements in budget management, leading to a material improvement in the city's budgetary performance, resulting in declining debt burden and a more positive reassessment of the municipality's management.

## **Rationale**

The affirmation reflects our expectation that the central government will fully compensate any economic and financial effect in Sweden stemming from the coronavirus outbreak. We also anticipate that Sundsvall will maintain a strong liquidity position and be successful in its cost rationalization efforts, leading to surpluses against the regulatory balanced budget requirement throughout 2020 to 2022. We expect slight deficits in social services will persist, as well as high investment needs, but that deficits after borrowings will not exceed 5%.

## **Less stringent cost management counterbalances strong economic fundamentals**

Swedish local and regional governments (LRGs) benefit from an extremely predictable and supportive institutional framework. In our view, the system has a high degree of institutional stability, where the sector's revenue and expenditure management is based on the far-reaching equalization system and local tax autonomy. That said, we have observed that expenditure has increased, following central government policy making, which, in combination with insufficient central government support mechanisms and LRGs' countermeasures, has eroded the sector's performance. Consequently, we regard the trend for the institutional framework for Swedish LRGs as weakening.

Sundsvall benefits from Sweden's very favorable economic fundamentals, reflected by our 2020 estimate of national GDP per capita of about \$53,300. Sundsvall's local economy is relatively diverse and we expect it will be able to weather a short-term disruption, resulting from the spread of the coronavirus, with support from the central government. Although the unemployment rate of 8.2% is slightly higher than the national average, it is stronger than that of international peers.

However, we believe the city has experienced some continued difficulties in controlling deficits in social services and schools. This points to a weaker political ability to ensure fiscal stability and adherence to budget targets. In our view, this has led to weak operating balances and low readiness for any extraordinary costs, which has resulted in a breach of the regulatory balanced budget requirement over the past two years. However, the municipality is implementing cost rationalizations, digitalization efforts, and changes to administrative processes that are expected to gain full effect in 2021, which should create a slightly higher financial headroom and allow for a balanced budget in 2020. Moreover, we believe the city's management displays sound liquidity management practices.

## **Debt levels are set to increase due to continued high onlending to the company sector and municipal investments**

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Over the next two years, we expect Sundsvall's investments will be slightly lower than we have previously seen, at about Swedish krona (SEK) 567 million per year, as we believe there might be difficulties in carrying out the planned investments if the coronavirus epidemic escalates. The investments, together with annual onlending of SEK315 million on average to the company sector, will be used to finance investments in municipal services in the area. We expect the operating balance will be maintained, averaging 3.9% of operating revenues in 2020-2022 (slightly above the average of 2.6% over 2018-2019, which included extraordinary costs). We anticipate that Sundsvall will generate SEK433 million of capital revenue in 2020, leading to surplus after capital accounts of about 2.1% of operating revenues. We expect this revenue will be generated by liquidating its 50% ownership in insurance company Kommungaranti Skandinavien Försäkrings AB. However, we believe the investment levels will result in a structural deficit after capital accounts of 3.2% on average of operating revenues in 2021-2022.

Because of the need for investments and onlending to municipal companies to finance their investments, we forecast a steady increase in Sundsvall's debt through 2022. Large development projects within the public housing company Mitthem AB and property developer Skifu AB, combined with upcoming projects in Sundsvall Logistikpark AB, lead us to anticipate that the municipality will onlend SEK946 million over 2020-2022, resulting in additional borrowing needs. We expect Sundsvall's direct debt will reach 134% of operating revenues in 2022, up from 127% in 2019. Because substantial parts of Sundsvall's direct debt are onlent to its companies, with Mitthem, wastewater treatment company Sundsvall Vatten AB, and Skifu as large borrowers. In our view, the nature of these companies' operations and their financial strength mitigate the city's high debt levels. We do not view any material risk arising from contingent liabilities stemming from guarantees, or any possible need to recapitalize public companies.

We view Sundsvall's liquidity position as strong. It has strong access to the markets and comprehensive committed bank facilities. We estimate cash and committed facilities account for about 163% of debt service. The municipality has strengthened its liquidity position over the past few years. We expect the city will hold on average about SEK600 million in cash over the next 12 months, and average committed facilities and available checking accounts stood at SEK4.1 billion as of March 10, 2020.

Sundsvall has a range of funding alternatives, which reduces refinancing risk. Funding is largely through a SEK10 billion medium-term note program and a SEK3 billion commercial paper program. Overall, we consider the municipality's debt management prudent and, for our base case, we assume that Sundsvall will maintain the long-term nature of its loan portfolio and an exceptional liquidity position over 2020-2022.

## Key Statistics

Table 1

### Municipality of Sundsvall Selected Indicators

	--Fiscal year end Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenues	7,081.0	7,145.0	7,482.5	7,654.0	7,847.0	8,048.0
Operating expenditures	6,658.0	6,962.9	7,281.9	7,351.7	7,538.0	7,727.9
Operating balance	423.0	182.1	200.6	302.3	309.0	320.1
Operating balance (% of operating revenues)	6.0	2.5	2.7	3.9	3.9	4.0
Capital revenues	2.0	24.0	1.9	433.0	0.0	0.0
Capital expenditures	634.0	700.0	647.7	564.5	544.5	590.5
Balance after capital accounts	(209.0)	(493.9)	(445.2)	170.9	(235.5)	(270.4)
Balance after capital accounts (% of total revenues)	(3.0)	(6.9)	(5.9)	2.1	(3.0)	(3.4)
Debt repaid	2,000.0	2,450.0	2,640.0	2,750.0	3,000.0	3,300.0
Gross borrowings	2,375.0	3,061.0	3,774.0	2,981.0	3,621.5	3,744.0
Balance after borrowings	(138.0)	11.1	290.3	14.9	0.0	(0.4)
Direct debt (outstanding at year-end)	7,774.0	8,335.0	9,468.9	9,700.0	10,321.5	10,765.5
Direct debt (% of operating revenues)	109.8	116.7	126.5	126.7	131.5	133.8
Tax-supported debt (outstanding at year-end)	8,501.0	9,066.0	9,931.2	10,162.0	10,783.5	11,227.5
Tax-supported debt (% of consolidated operating revenues)	97.9	103.6	108.8	109.1	113.0	114.8
Interest (% of operating revenues)	1.5	1.2	1.1	1.4	1.6	1.8
National GDP per capita (single units)	462,328.7	477,636.0	490,591.4	500,645.7	512,880.7	526,970.7

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.

## Ratings Score Snapshot

Table 2

## Municipality of Sundsvall Ratings Score Snapshot

Key rating factors	Score
Institutional framework	1
Economy	1
Financial management	3
Budgetary performance	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 Remains Stable, Feb. 14, 2020

## 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Public Finance System Overview: Swedish Municipalities And Regions, Dec. 3, 2019
- Sovereign Risk Indicators, Dec. 12, 2019. An interactive version is available at [www.spratings.com/sri](http://www.spratings.com/sri).
- S&P Publishes 2020 Outlook For Local And Regional Governments Outside The U.S., Nov. 18, 2019
- S&P Global Ratings Definitions, Sept. 18, 2019
- 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- A Potential Profit Cap On Private Operators In Sweden's Welfare Sector Could Increase LRG Spending, March 11, 2019

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- European Local And Regional Government Risk Indicators, Nov. 9, 2018
- Sweden's Unclear Parliamentary Situation Clouds Local Governments' Future Financial Policy, Oct. 4, 2018

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

#### Sundsvall (Municipality of)

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

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