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Research Update:

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

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Overview

- Despite increasing investments in core municipal infrastructure, we expect Södertälje will benefit from divestments in its company sector, allowing it to reduce debt over our forecast period through 2019.
- In addition, on the back of capital revenues and strong operating budget execution, we believe that Södertälje will continue to post a strong budgetary performance and surpluses after capital accounts through year-end 2019.
- We are affirming our 'AA+/A-1+' and 'K-1' ratings on Södertälje.
- The stable outlook reflects our expectation that Södertälje's performance and debt profile will remain stable through year-end 2019.

Rating Action

On Dec. 8, 2017, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on the Swedish Municipality of Södertälje. The outlook is stable.

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

Outlook

The stable outlook reflects our expectation that Södertälje will continue to post a strong budgetary performance over the coming two years, with surpluses after capital accounts through year-end 2019. Although we expect Södertälje's companies to ramp up investments in the coming years, we anticipate a stabilization of debt.

Downside Scenario

We could consider a negative rating action over the coming two years if Södertälje's management allowed budgetary performance to deteriorate, leading to an operating deficit, and in the absence of a remedial action plan. This could, in turn, lead to marked deficits after capital accounts and a notable increase in debt ratios. In this downside scenario, if we observed that Södertälje's management was not counteracting the deterioration or it had adopted less prudent treasury practices, we would revise our assessment of financial management downward and lower our long-term rating.

Upside Scenario

We could consider raising the rating over the coming two years if Södertälje's liquidity structurally improved to a level we considered to be exceptional, and if direct debt reduced significantly, lowering the overall debt burden and interest expense. In addition, in our upside scenario, we would expect a smaller negative

budgetary impact stemming from Södertälje's relatively weak demographic profile. That said, we consider our upside scenario unlikely to materialize over our 2017-2019 forecast period.

Rationale

The ratings are supported by our assessment of Södertälje's very strong financial management and Sweden's institutional framework, which we view as extremely predictable and supportive. Södertälje's strong liquidity, strong budgetary performance, low contingent liabilities, and strong local economy further underpin the ratings. However, we still consider the city's demographics as vulnerable, which in our view could push up its expenditures. In addition, the city's moderate debt burden and its average budgetary flexibility are less supportive factors.

Socioeconomic challenges eased by Sweden's equalization system and Södertälje's budgetary discipline

The Swedish equalization system is, in our view, predictable and supportive and we consider it a key component of our ratings on Södertälje. Furthermore, we consider Sweden's local and regional government (LRG) system displays high institutional stability. The LRG sector's revenue and expenditure management is based on a far-reaching equalization system and autonomy in setting local taxes.

Södertälje's local economy is strong and benefits from well-developed infrastructure and close integration with the dynamic region surrounding Sweden's capital, Stockholm. The Swedish equalization system evens out wealth among Swedish LRGs, so we use the average national GDP per capita of US\$54,000 for the past three years as a starting point in our analysis. Södertälje's demographic structure translates into high expenditures. The unemployment rate is high, at 13.3% in October 2017, exceeding both the national average of 7.4% and the average in Stockholm County of 6.1%, leading to lower tax revenues and pressure on some expenditure items. The demographic pressure related to asylum seekers coming to Södertälje has eased significantly since 2015, but we continue to believe that the existing population characteristics could weigh negatively on Södertälje's budgetary performance as the city's demographic disposition is not fully compensated by the equalization system. This constrains our assessment of Södertälje's economy.

The socioeconomic challenges are to some extent mitigated by Södertälje's prudent budgetary discipline, which produces overall strong budgetary performance. Södertälje posted an operating balance of 5.0% of operating revenues in 2016, averaging 3.9% of operating revenues between 2014 and 2016. At the same time, Södertälje's contained investments and significant capital revenues have helped to produce strong surpluses after capital accounts of 3.3% of total revenues over the same period. Södertälje's ability to post a surplus after capital accounts has been a key driver of its debt reduction. For 2017, we forecast a robust operating margin at 5.1% of operating revenues, stemming from containment of expenditures and robust revenue developments. We believe the operating margin will stabilize at a lower level toward the end of our forecast period, averaging 3.7% of operating revenues over 2017-2019. We note that the surplus after capital accounts in 2016, amounting

to 5.9%, was boosted by capital revenues stemming from capital gains in land developments. Although we estimate that such income will remain a meaningful source of revenues in our base case through 2019, we don't expect it to reach the level of 2016. We therefore anticipate a stabilization of the surplus after capital accounts at an average of 1.3% of total revenues over 2017-2019.

We expect Södertälje to maintain its prudent debt management and strive for contained debt levels over the medium to long term. We consider Södertälje's management is very adept in enforcing budgetary discipline, which is crucial, given the municipality's challenging socioeconomical situation that puts pressure on expenditures. We have observed political consensus especially regarding key elements such as the city's finances, and we would expect Södertälje to counteract budgetary deterioration if it occurred. On the financial side, we consider management to be very competent, with strong control of the debt stock and ability to keep refinancing risks at a minimum.

In our view, Södertälje has institutionalized revenue flexibility, owing to Swedish municipalities' taxing autonomy, in combination with the comprehensive equalization system. This is an important factor in our assessment as it in part compensates for the rigid expenditure structure. In addition, Södertälje's large company sector has historically provided revenues from asset sales, which we expect to continue.

Upcoming investments are unlikely to translate into a materially higher debt burden

Södertälje's debt has continued to decrease, owing to a strong budgetary performance and capital revenues from the municipality and its company sector. Södertälje's debt is related to the company sector, for which the municipality acts as an in-house bank. The city faces major upcoming investments, and its property company (Telge Fastigheter) and housing company (Telge Bostäder) are expected to ramp up investments in 2018 and 2019. Despite this, we foresee further reduction of municipal debt in the short term, owing to strong cash flows and capital revenues from anticipated asset sales. In 2019, we expect Södertälje's debt reduction to bottom out, leading to a stabilization of debt metrics as the city again becomes a net borrower. We forecast direct debt at 114% of operating revenues by the end of 2019. That said, we do not rule out that additional asset sales may ease the city's borrowing needs and further improve our debt metrics.

We forecast Södertälje's capital expenditures will average Swedish krona (SEK)193 million (€19.4 million) in 2017-2019. This is somewhat lower compared with our last review and reflects our expectation of an additional lag in the completion of its budgeted investments. However, the bulk of the city's investment lies within the company sector and is set to increase significantly in the coming years as key real estate projects come on stream.

We continue to consider Södertälje's liquidity as strong, owing to sound internal liquidity, ample committed bank facilities, and our assessment of strong market access. Södertälje has SEK3.1 billion in committed bank facilities to cover refinancing needs. As of Dec. 1, 2017, we estimate Södertälje's cash and committed bank facilities will cover 100.7% of maturing debt over the following 12 months,

including our estimate of new financing required for municipal investments and the refinancing of commercial paper. Södertälje has shortened the maturity profile of its debt portfolio somewhat in 2017, to enable amortization as management expects borrowing needs to decrease in the short term.

We continue to view Södertälje's market access as strong, since Södertälje regularly taps the capital markets. The city has an SEK8 billion medium-term note program and a SEK4 billion commercial paper program. Södertälje also has access to traditional bank borrowing and private placements. In addition, as a member of Sweden's local government funding agency, Kommuninvest i Sverige AB, Södertälje has signed joint and several guarantees of Kommuninvest's obligations. However, we currently do not envisage a scenario in which Kommuninvest's operations would falter to the extent that these guarantees would be called upon. Furthermore, because we incorporate the municipal companies' debt into Södertälje's debt ratio, we consider only guarantees extended to the company sector as contingent liabilities. Following the sale of Telge Kraft in 2016, we assess Södertälje's contingent liabilities as low.

Key Statistics

Table 1

Municipality of Södertälje Key Statistics

(Mil. SEK)	—Fiscal year end Dec. 31—					
	2014	2015	2016	2017bc	2018bc	2019bc
Operating revenues	6,490	6,334	6,541	6,843	7,034	7,219
Operating expenditures	6,270	6,125	6,214	6,493	6,834	6,991
Operating balance	220	209	327	350	200	228
Operating balance (% of operating revenues)	3.4	3.3	5.0	5.1	2.8	3.2
Capital revenues	20	101	224	32	35	20
Capital expenditures	159	138	151	192	218	170
Balance after capital accounts	81	172	400	189	18	79
Balance after capital accounts (% of total revenues)	1.2	2.7	5.9	2.7	0.2	1.1
Debt repaid	2,909	2,400	1,549	2,990	2,800	3,580
Gross borrowings	2,300	2,101	(3)	2,705	2,177	4,142
Balance after borrowings	209	80	(278)	8	0	0
Modifiable revenues (% of operating revenues)	52.3	56.4	57.2	56.9	57.4	57.6
Capital expenditures (% of total expenditures)	2.5	2.2	2.4	2.9	3.1	2.4
Direct debt (outstanding at year-end)	10,405	10,102	8,550	8,265	7,642	8,203
Direct debt (% of operating revenues)	160.3	159.5	130.7	120.8	108.6	113.6
Tax-supported debt (outstanding at year-end)	12,020	11,635	9,301	9,016	8,393	8,954
Tax-supported debt (% of consolidated operating revenues)	119.0	111.9	86.0	80.4	72.8	75.8
Interest (% of operating revenues)	4.4	3.3	2.7	2.6	2.6	2.6
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	408,180	428,947	444,134	458,621	473,105	487,085

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 Sodertalje Ratings Score Snapshot

Key rating factors

Institutional framework	Extremely predictable and supportive
Economy	Strong
Financial management	Very strong
Budgetary flexibility	Average
Budgetary performance	Strong
Liquidity	Strong
Debt burden	Moderate
Contingent liabilities	Low

*S&P Global Ratings bases its credit ratings on local and regional governments (LRGs) on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments" summarizes how the eight factors are combined to derive the foreign currency rating on an LRG.

Key Sovereign Statistics

Sovereign Risk Indicators, Oct. 13, 2016. An interactive version is also available at <http://www.spratings.com/sri>.

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - August 14, 2017
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017

Related Research

- Sovereign Risk Indicators, October 13, 2016. An interactive version is also available at <http://www.spratings.com/sri>.
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local And Regional

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Government Default Study And Rating Transitions - May 08, 2017

- Swedish Local And Regional Government Risk Indicators: April 2017 Update - April 05, 2017
- Sweden's New Equalization System Will Hurt Some LRGs' Finances But Not Their Credit Quality - February 09, 2015

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

	Rating	
	To	From
Sodertalje (Municipality of)		
Issuer Credit Rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Stable/A-1+
Nordic Regional Scale	-/-/K-1	-/-/K-1
Senior Unsecured		
Foreign and Local Currency	AA+	AA+
Commercial Paper		
Nordic Regional Scale	K-1	K-1

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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. 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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