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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

- We expect Södertälje's debt will remain stable through 2020, despite rather high investments mainly related to the company sector. We anticipate some onlending in 2019-2020, although the companies are likely to repay debt in 2018 as asset sales materialize.
- Due to a change in our ratings approach for local and regional governments in which we now take into account capital expenditures related to core municipal activities conducted by fully owned subsidiaries, our assessment of Södertälje's budgetary performance has somewhat weakened.
- We are affirming our 'AA+/A-1+' and 'K-1' ratings on Södertälje.
- The stable outlook reflects our view that Södertälje will maintain its strong liquidity position over the coming two years, supported by its strong management.

Rating Action

On June 8, 2018, 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 view that Södertälje will maintain its strong liquidity position through year-end 2020. Furthermore, we expect Södertälje's financial management to maintain its prudent liquidity management and remain committed toward its financial policies.

Downside Scenario

We could consider a negative rating action over the coming two years if we observed a marked deterioration in Södertälje's liquidity coverage ratio. If this downside scenario were also accompanied by a more relaxed attitude toward financial policies, we would negatively reassess Södertälje's financial management and lower the long-term rating.

Upside Scenario

We could consider raising the rating over the coming two years if Södertälje's debt burden decreased to levels we regard as low. An upgrade could also hinge on a structural improvement in Södertälje's liquidity to our exceptional category, likely from reduced maturing debt on the back of a lower debt burden, as well as markedly stronger budgetary performance. This could happen if the municipality further tightens control over expenditures, resulting in an improved operating balance. That said, we consider these upside scenarios unlikely over our 2018-2020 forecast period.

Rationale

The ratings are supported by our assessment of Södertälje's very strong financial management and Sweden's extremely predictable and supportive institutional framework. Södertälje's strong liquidity, low contingent liabilities, and strong local economy further underpin the ratings. We still regard the city's demographics as vulnerable, which in our view could push up its expenditures. Because we now factor in the capital accounts related to public-service-related properties, which we see as core municipal activities, we now consider Södertälje's budgetary performance as average. This, in combination with the city's moderate debt burden and its average budgetary flexibility, weighs on the city's credit standing.

Strong management and budgetary discipline offset socioeconomic challenges

We consider the predictable and supportive Swedish equalization system as 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.

As a basis for our analysis of Södertälje, we use the three-year average national GDP per capita amounting to \$52,000. We use national GDP per capita because of the extensive equalization system that evens out differences in wealth between Swedish LRGs. We consider Södertälje's local economy as strong and diversified, with strong ties to the trucking and pharmaceutical industries. Furthermore, the city has a net inflow of workers from other municipalities. This stems from a well-developed infrastructure and close integration with the dynamic Stockholm region. Despite this, Södertälje has one of the most vulnerable socioeconomic profiles in the Stockholm region, and among our rated LRGs in the Nordics. There is a mismatch between the competence of the workforce and the demand from the labor market, as a large part of the population has little or no education. Consequently, Södertälje's unemployment (12.1% in April 2018) is considerably higher than both the average unemployment in the region (5.9%), and the national level (7.0%). Furthermore, as Södertälje's demographic profile is not fully compensated by the equalization system, we consider that the demographic profile potentially

constrains Södertälje's budgetary performance.

In our opinion, Södertälje's budgetary discipline partially offsets the socioeconomic challenges. In 2017, Södertälje posted a strong operating balance of 7.2%. As a result, Södertälje's surplus after capital accounts reached 4.5% of total revenues, despite increased capital expenditures compared with 2016. Going forward, we expect the operating margin to stabilize at slightly lower levels and average about 3.8% in the forecast period, driven by increased operating expenditures related to demographic factors. We expect the surplus after capital accounts to average 1.73% for the coming years, which is weaker than the levels in 2016 and 2017. This is partly from a conservative forecast as regards capital revenues related to land development, which boosted the result in 2016, as these revenues are volatile and difficult to predict.

We have changed our approach from our last review concerning Södertälje's public-service related properties, which we consider to be a core municipal activity. As Södertälje manages these assets through its subsidiary Telge Fastigheter, our performance metric is artificially improved, since related capital expenditures are not reflected. As the inclusion of these capital accounts burdens the balance after capital accounts, we now consider Södertälje's budgetary performance as average, versus strong in our last review. This is the same approach we use for other Swedish municipalities.

In our view, Södertälje's management is very adept in enforcing budgetary discipline, which is crucial, given that the municipality's expenditure structure may become constrained because of the socioeconomic profile. We have observed political consensus regarding key financial elements, such as budgetary discipline and conservativeness with regard to debt, and we would expect Södertälje to counteract budgetary deterioration if it occurred. We also expect management to remain prudent, and, despite investments, keep the debt stable over the coming years. Furthermore, we consider the financial management 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, together with the comprehensive equalization system. This is an important factor in our assessment, since it somewhat 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.

Decreasing debt burden, despite upcoming investments

For several years now, Södertälje has amortized on its external debt, owing to strong budgetary performance and capital revenues from the municipality and its company sector. It is primarily the housing company, Telge Bostäder, and the property company, Telge Fastigheter, that face large upcoming investments, and will likely require some onlending from the municipality in 2019-2020. Despite this, we foresee that direct debt will continue to decrease as a share

of operating revenues throughout the forecast period, amounting to 110.42% by year-end 2020. The decrease will be driven by anticipated strong results, both within the municipality and the company sector, alongside cash inflows from asset sales this year. Although we have not accounted for additional divestment in 2019-2020, we acknowledge that additional asset sales would likely further decrease the borrowing needs.

Södertälje had a higher completion rate on its investments in 2017 than historically. We consider this to be a matter of timing vis á vis the life-cycle of ongoing projects, and not a structural improvement. We therefore forecast Södertälje's capital expenditures will average Swedish krona (SEK) 208 million (about €20 million) annually in 2018-2020. That said, 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. The company sector has budgeted investments of about SEK1.5 billion on average per year in 2019 and 2020.

Södertälje's liquidity remains 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 end-April 2018, we estimate Södertälje's cash and committed bank facilities will cover 108.6% of maturing debt over the coming 12 months, including our estimate of new financing required for municipal investments and the refinancing of commercial paper. As mentioned in our previous review, Södertälje shortened the maturity profile of the debt portfolio by increasing the use of commercial paper to enable amortization, as management expects cash inflows from asset sales during 2018. We expect Södertälje will maintain its prudent liquidity management and extend the maturity profile of the portfolio over the coming years as the need for preparedness concerning debt amortization diminishes.

We continue to view Södertälje's market access as strong, since Södertälje regularly taps the capital markets. The city has a 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. We currently assess Södertälje's contingent liabilities as low.

Key Statistics

Table 1

Municipality of Sodertalje - Selected Indicators						
(Mil. SEK)	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	6,334	6,541	6,893	6,888	7,088	7,300
Operating expenditures	6,125	6,214	6,395	6,603	6,818	7,036
Operating balance	209	327	498	285	270	264
Operating balance (% of operating revenues)	3.3	5.0	7.2	4.1	3.8	3.6
Capital revenues	101	224	56	55	56	64
Capital expenditures	138	151	241	223	197	203
Balance after capital accounts	172	400	313	117	129	125
Balance after capital accounts (% of total revenues)	2.7	5.9	4.5	1.7	1.8	1.7
Debt repaid	2,400	2,768	3,180	2,650	3,719	2,901
Gross borrowings	2,101	1,216	2,568	2,479	3,830	3,085
Balance after borrowings	80	(278)	(87)	95	0	0
Modifiable revenues (% of operating revenues)	56.4	57.2	57.0	58.7	59.0	59.0
Capital expenditures (% of total expenditures)	2.2	2.4	3.6	3.3	2.8	2.8
Direct debt (outstanding at year-end)	10,102	8,550	7,937	7,766	7,877	8,061
Direct debt (% of operating revenues)	159.5	130.7	115.1	112.7	111.1	110.4
Tax-supported debt (outstanding at year-end)	11,635	9,301	8,651	8,480	8,591	8,775
Tax-supported debt (% of consolidated operating revenues)	111.9	86.0	77.1	74.9	73.8	73.4
Interest (% of operating revenues)	3.3	2.7	2.6	2.7	2.6	2.6
Local GDP per capita	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
National GDP per capita	430,872	447,142	460,644	477,049	491,629	506,407

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 Sodertalje Ratings Score Snapshot	
Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Strong
Financial management	Very strong
Budgetary flexibility	Average
Budgetary performance	Average
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 - April 10, 2018. An interactive version is also available at <http://www.spratings.com/sri>.

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 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, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Research Update: Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, March 2, 2018
- Swedish Municipality of Sodertalje 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, Dec. 8, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local And Regional Government Default Study And Rating Transitions, May 8, 2017
- Swedish Local And Regional Government Risk Indicators: April 2017 Update, April 5, 2017
- Sweden's New Equalization System Will Hurt Some LRGs' Finances But Not Their Credit Quality, Feb. 9, 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

Ratings Affirmed

Sodertalje (Municipality of)

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