Research Update:

Swedish Municipality Of Orebro Outlook Revised To Positive On Expected Debt Reduction; 'AA+/A-1+' Ratings Affirmed

March 29, 2024

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Overview

- We forecast lower-than-expected borrowing needs for the Municipality of Orebro, underpinned by our assumption that investments to municipality-owned companies will decrease following an investment peak on refurbishment of municipal properties in 2023.
- Consequently, we expect Orebro's debt will gradually decrease and revenue will continue to increase, leading to a steady improvement of Orebro's debt position.
- Orebro's budgetary discipline, together with lower capital spending, will lead to maintained surpluses after capital accounts through 2026.
- We therefore revised our outlook to positive from stable and affirmed our 'AA+/A-1+' issuer credit and 'K-1' Nordic regional scale ratings on the municipality.

Rating Action

On March 29, 2024, S&P Global Ratings revised its outlook on the Swedish municipality of Orebro to positive from stable. We also affirmed our 'AA+/A-1+' issuer credit and 'K-1 Nordic regional scale rating on the municipality.

Outlook

The positive outlook reflects our view that Örebro will be able to reduce debt in relation to revenue, such that debt to revenue will steadily decrease through fiscal 2026. The outlook also reflects our view that the municipality will adhere to budget control and uphold strong operating balances and surpluses after capital accounts.

Downside scenario

We would revise the outlook to stable if Orebro cannot contain operational or capital spending, leading to further debt, and stabilize or increase the debt-to-revenue ratio.

Upside scenario

We could consider an upgrade in the coming two years if we perceive that Orebro's debt will continue falling, and eventually decrease significantly below 120% of revenue on a sustained basis. This could result from stronger growth in revenue and low debt financing needs, while the municipality maintains strong operating balances and surpluses after capital accounts in line with our base-case scenario.

Rationale

The outlook revision reflects our view that Orebro has passed its peak investment period, and the municipality will now need less debt financing than we previously assumed. This is underpinned by our assumption that population growth, while still increasing, will be slower than we previously expected. Therefore, while there will be demand for more childcare facilities and schools, it will not be as high as previously predicted, resulting in comparatively lower investment needs. At the same time, we project that management will uphold strong operating performance, which will further support the municipality's maintaining surpluses after capital accounts.

Extremely supportive institutional framework continues to support Orebro'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 local and regional governments, for example through additional grants distributed in response to the COVID-19 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).

We view the political situation in Orebro as stable and have observed consensus regarding long-term strategies across the political spectrum locally. The municipality is governed by a majority coalition of Social Democrats, the Moderate Party, and the Centre Party, and we view positively the stability created from having a majority in place. In our view, Orebro's budgetary control is in line with that of comparable Swedish peers, although with historically higher debt. However, we observe that Orebro is ahead of many peers when it comes to refurbishment and expansion of core municipal properties. We expect management will remain committed to budgetary discipline and undertake necessary measures to comply with the balanced budget requirement. Orebro's debt and liquidity management are centralized through the in-house bank, which is responsible for the funding needs of the municipality and its companies. In our view, the treasury adheres to prudent financial policies.

Orebro benefits from Sweden's high wealth levels and strong economic fundamentals, with an estimated national GDP per capita of about $57,600 in 2024. The municipality is a regional growth center, with a dynamic and well-diversified local economy. Unemployment and income levels are roughly in line with national averages.

Lower capital spend will lead to minimal debt funding from 2025, resulting in lower debt

Orebro's operating balance fell back below 5% in 2023, and we believe it will remain near this level for the next two years. This is slightly weaker than in recent years, when the municipal sector was generously compensated with grants by the central government via its pandemic measures. While tax revenue is expected to increase more slowly in 2024, we expect tax revenue growth of 4.6% for 2025-2026 as the Swedish economy recovers. Despite continued pressure on operating expenditure from inflation and a new pension agreement in 2023, we expect revenue growth will continue to support Orebro's operational performance. We expect Orebro and the Swedish municipal sector as a group will improve margins from 2025, as economic growth pushes tax revenue to outpace expenditure growth.

While operating balances remain subdued in 2024, we forecast the municipality will post surpluses after capital accounts, due to lower investments in its subsidiary Futurum. This company carries out core municipal services related to school properties and recently completed a large refurbishment program of the properties it owns and manages for the municipality. As such, we include Futurum's borrowing needs in the municipal balance after capital accounts. However, since the company has caught up on its properties' refurbishment needs and population growth is now expected to be slower than forecast, resulting in reduced need for investments in childcare facilities and schools, we view Futurum as having passed its investment peak. We now expect the company will amortize about Swedish krona (SEK) 100 million ($9,5 million) annually on its debt, which supports the municipality's after-capital-accounts balance.

Orebro had SEK18.9 billion in debt, corresponding to 132% of revenue at year-end 2023, which we expect will decrease to 125% by year-end 2026 through slower debt uptake and continued revenue growth. The debt position is largely fueled by the capital needs of the municipality-owned housing company Orebrobostader AB (OBO). OBO is the largest borrower among the municipal companies, holding 52% of the total debt. While OBO increased debt considerably in 2023, we expect that borrowing needs will gradually decrease from 2024, partly due to rising construction costs which we believe will constrain new development. Further support may come from asset sales, having received a mandate from the political majority to help fund the refurbishment of existing properties. We continue to view on-lending to OBO as mitigating our overall assessment of Orebro's debt, based on the company's strong financial profile. This is underpinned by stable noncyclical operating cash flow on the back of high demand for rental housing. Adjusting for on-lending to OBO, Orebro's direct debt will fall to 64% of operating revenue by year-end 2024. We continue to regard the municipality's contingent liabilities, including its joint and several guarantee to Kommuninvest, as limited.

Since interest rates have increased rapidly over the past 1.5 years, interest expenditure as a share of revenue will almost double in 2024 from 2022. However, we think the share will stabilize at about 3.5% as interest rates are expected to decrease in 2024. However, since Orebro's entire debt burden has been on-lent to its subsidiary companies, which service the debt, we expect higher interest expenditure will be accompanied by matching higher interest income, mitigating the impact on the municipality's budget. Although we believe core municipal services managed by municipal subsidiaries, such as Futurum, will receive higher contributions through increased fees and rents from the municipality, we expect municipality-owned companies with commercial revenue, such as OBO, can absorb increasing interest expenditure without owner support.

Orebro's liquidity position remains solid, and we estimate the weighted debt-service-coverage ratio at 134%. We forecast the ratio will remain comfortably above the 120% threshold over the next two years. The liquidity position is supported by ample reserves of cash holdings, financial assets (to which we applied discounts based on the security's underlying credit quality), committed facilities, and strong access to external liquidity. Orebro's funding sources are diversified through a SEK12 billion medium-term note program, a SEK5 billion commercial paper program, and borrowings from Kommuninvest. We expect Orebro will maintain its relative share of commercial paper as part of the debt portfolio, prioritizing long-term funding. Overall, we expect relatively stable debt repayments through 2026.

Key Statistics

Table 1

Municipality of Orebro--Selected indicators

(Mil. SEK)	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenues	12,367	13,054	14,323	14,928	15,586	16,046
Operating expenditures	11,390	12,105	13,680	14,268	14,842	15,131
Operating balance	977	949	643	660	744	915
Operating balance (% of operating revenues)	7.9	7.3	4.5	4.4	4.8	5.7
Capital revenues	196	209	384	175	175	175
Capital expenditures	917	839	860	816	800	908
Balance after capital accounts	256	319	167	18	119	182
Balance after capital accounts (% of total revenues)	2.0	2.4	1.1	0.1	0.8	1.1
Debt repaid	4,400	4,237	4,600	5,090	5,150	5,100
Gross borrowings	5,450	5,337	5,482	5,900	5,700	5,000
Balance after borrowings	55	57	(153)	(43)	(3)	(24)
Direct debt (outstanding at year-end)	16,900	18,000	18,882	19,692	20,242	20,142
Direct debt (% of operating revenues)	136.7	137.9	131.8	131.9	129.9	125.5
Tax-supported debt (outstanding at year-end)	17,630	18,757	18,882	20,480	21,117	21,082
Tax-supported debt (% of consolidated operating revenues)	118.7	119.9	111.1	116.3	115.1	111.7
Interest (% of operating revenues)	2.0	2.2	3.1	3.6	3.6	3.5
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	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

Municipality of Orebro--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.spratings.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

- Subnational Debt 2024: Focus on Debt Sustainability, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Subnational Debt 2024: Global LRGs Can Handle Rising Interest Expenses, Feb. 29, 2024
- 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 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; Outlook Action

	To	From
Orebro (Municipality of)		
Issuer Credit Rating	AA+/Positive/A-1+	AA+/Stable/A-1+
Ratings Affirmed		
Orebro (Municipality of)		
Issuer Credit Rating		
Nordic Regional Scale	--/--/K-1	
Senior Unsecured	AA+	