Research Update:

Swedish Municipality of Linkoping Ratings Affirmed At 'AA+/A-1+'; Outlook Stable

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Overview

- We forecast significantly weaker tax-revenue growth following the COVID-19 pandemic, temporarily pressuring Linköping's operating performance and increasing the risk of balanced budget deficits.
- Nevertheless, we anticipate Linköping will use its inherent flexibility and provisioned reserves to bridge deficits against regulatory requirements and foster recovery of its performance.
- Despite high company sector investments, we expect Linköping will control its increasing debt, including contingent liabilities.
- We are therefore affirming our 'AA+/A-1+' long- and short-term ratings on Linköping, and keeping the outlook stable.

Rating Action

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

Outlook

The outlook is stable because we think Linköping will contain its debt burden, despite budgetary pressure stemming from the COVID-19 pandemic, including contingent liabilities related to extended guarantees, at the current level. The outlook also incorporates our expectation that management will stay committed to prudent financial policies and uphold its very favorable liquidity position.

Upside scenario

We could consider raising the ratings on Linköping if we observed a marked and structural improvement in the municipality's debt position. This would stem from reduced debt levels at public entities Linköpings Stadshus AB (AA+/Stable/A-1+) or Lejonfastigheter AB (AA-/Stable/A-1+).

Downside scenario

We could consider a negative rating action if Linköping is unable to capitalize on its flexibility to contain its debt burden, for example, owing to a worsened fiscal position triggered by the COVID-19 pandemic or high investments in its companies. In this scenario, a downgrade could occur if Linköping's liquidity was depleted, for example because of increased borrowing by Linköpings Stadshus. We could also consider a downgrade if long-term systemic support to Linköping, and the Swedish local and regional government (LRG) sector, were insufficient.

Rationale

Due to the economic slowdown caused by the COVID-19 pandemic, we expect weaker operating performance and an increased risk of negative bottom-line results through 2022. We expect Linköping to bridge any regulatory deficit using provisioned reserves, thus fostering a structural recovery of the operating performance supported by its strong local economy, internal countermeasures, and central government support.

Due to upcoming investments, we expect Linköping's debt burden, including extended guarantees to its companies, will increase moderately over the coming two years. That said, we believe Linköping has above-average flexibility related to its large pool of sellable assets, mitigating risks to its financial position. We also expect Linköping to maintain its very favorable liquidity potion, supported by its large portfolio of liquid assets.

Increasing sectorwide risks could weigh on Linköping's fiscal position

We think that Sweden's institutional framework for LRGs is weakening. Moreover, owing to rising expenditure, accentuated by central government policymaking, insufficient compensation mechanisms, and LRG countermeasures, the sector's performance has weakened. Nevertheless, we still consider Sweden's institutional framework for LRGs as extremely predictable and supportive, thanks to its high degree of institutional stability, far-reaching equalization system, and local tax autonomy.

We regard the political situation in Linköping as stable, despite minority rule. Historically, majorities have shifted between the right and left, but we have nevertheless observed consensus regarding the long-term strategies for the city. We regard Linköping's civil servants team as prudent with good control of expenditures, evidenced by the fact that Linköping provides its services at the lowest tax rate in the region. The organizational structure is decentralized, with the majority of public services being provided from the city's companies. Linköping's debt and liquidity management therefore is decentralized, and we consider the city companies' management teams to be experienced and competent. In our view, the companies are a vital public policy tool for the municipality.

We regard Sweden's comparably high wealth level (we estimate 2020 national GDP per capita at a high $48,300) will be supportive of Linköping's credit quality. Linköping is the largest city in the Region of Östergötland and a natural commercial hub for the region's economy. Its business sector is diversified, with a marked presence of engineering and technology businesses. The city is also home to one of Sweden's top universities. Its employment structure and income levels compare well with both regional and national levels.

Fiscal impact from COVID-19-induced economic downturn will be partly mitigated by central government support and Linköping's above-average flexibility.

Similar to the rest of the LRG sector, we expect Linköping to post weaker operating performance over the coming years, as tax-revenue growth is impaired by the economic slowdown, although we consider the recently announced extra grants from the central government will partially compensate the shortfall. Furthermore, we believe the sectorwide demographic challenges and adverse effects from the revised equalization system will add to the pressure. However, we expect Linköping will bridge any regulatory deficit by using provisioned reserves, and facilitate a structural recovery on the back of internal countermeasures, including efficiency metrics, and central government support.

We forecast the municipality will continue significant investments over the coming years, although we expect some delays in 2020 related to COVID-19. In our projection of the municipality's capital expenditure, we include the borrowing need related to investments carried out by Lejonfastigheter, because we consider the company's operation to be core for the municipality. The municipality's own investments will be temporarily high over the coming years driven by investments related to a swimming facility. In combination with weaker operating performance, we anticipate Linköping will post wider deficits over the coming two years, versus historical levels.

We regard Linköping's revenue flexibility as stronger than that of peers. This flexibility is more pronounced on the capital side, in our view, related to its large number of sellable assets within its company sector, where, for instance, AB Stångåstaden (AA-/Stable/A-1+) has occasionally sold assets. However, the tax rate is lower than the regional and national levels. In our view, this is key to counterbalancing further stress on the fiscal position, should the economic downturn worsen.

We assume that Linköping's sizable investments will moderately increase its tax-supported debt over the coming two years, although we do not envisage an increase above 120% of consolidated revenue. We anticipate the municipality will start to accumulate debt over the coming two years because of a specific investment in a swimming facility, although the main drivers will be investments undertaken in two of Linköpings Stadshus' subsidiaries and Lejonfastigheter. We regard these two companies as tax-supported entities because of their role for Linköping. Moreover, we consider Linköping's contingent liabilities as limited. Owing to upcoming investments, we expect guaranteed debt held by Tekniska Verken i Linköping AB (A+/Stable/A-1) and Stångåstaden to increase, elevating Linköping's exposure to contingent liabilities to about 48% of consolidated revenue over the coming two years. We currently consider the guarantee exposure toward Swedish LRG funding agency Kommuninvest i Sverige AB, as limited.

Linköping's very favorable liquidity position stems from its sizable portfolio of liquid assets, and strong access to external liquidity. We estimate that the city's liquid assets cover 155% of debt service over the coming 12 months. We include in our liquidity calculations Swedish krona (SEK) 4.9 billion of cash and financial assets, to which we have applied appropriate haircuts. Although the capital markets are currently turbulent, we believe Linköping's liquidity position is relatively resilient to a notable depreciation of the assets' value. We estimate Linköping's funding needs at about SEK450 million over the coming 12 months, which is mainly related to Lejonfastigheter's investments included in the calculation. Due to Linköpings Stadshus' close relationship with its owner, we include the company's maturing debt and interests in the calculation, amounting to about SEK2.9 billion. Similar to other rated LRGs in Sweden, we consider Linköping has strong access to external liquidity, thanks to its established relationship with capital markets and financial institutions.

Key Statistics

Table 1

Municipality of Linkoping Selected Indicators

	--Fiscal year ending Dec. 31--					
(Mil. SEK)	**2017**	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	9,926	10,541	10,959	11,236	11,399	11,657
Operating expenditures	9,709	10,269	10,645	11,013	11,226	11,451
Operating balance	217	272	314	222	174	205
Operating balance (% of operating revenues)	2.2	2.6	2.9	2.0	1.5	1.8
Capital revenues	180	127	21	64	75	75
Capital expenditures	598	386	859	635	840	778
Balance after capital accounts	(201)	13	(524)	(349)	(591)	(498)
Balance after capital accounts (% of total revenues)	(2.0)	0.1	(4.8)	(3.1)	(5.2)	(4.2)
Debt repaid	0	0	0	0	30	41
Gross borrowings	0	0	0	300	139	233
Balance after borrowings	(197)	13	(411)	(49)	(482)	(305)
Direct debt (outstanding at year-end)	0	0	0	300	409	602
Direct debt (% of operating revenues)	0.0	0.0	0.0	2.7	3.6	5.2
Tax-supported debt (outstanding at year-end)	10,628	10,626	11,225	12,264	12,699	13,388
Tax-supported debt (% of consolidated operating revenues)	105.0	98.8	100.5	107.3	109.5	112.8
Interest (% of operating revenues)	0	0	0	0	0	0.1
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	462,329	477,635	491,337	465,130	492,961	512,985

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 Linkoping Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2

Table 2

Municipality of Linkoping Ratings Score Snapshot (cont.)

Key rating factors	Scores
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, April 24, 2020. An interactive version is also available at http://www.spratings.com/sri

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

- Full Analysis: Tekniska verken i Linkoping AB, March 12, 2020.
- Swedish Government To Mitigate Impact From Coronavirus On Local And Regional Governments, March 11, 2020
- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable, Feb. 14, 2020
- Research Update: Swedish Real Estate Company Lejonfastigheter 'AA-/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, Jan. 24, 2020.
- Research Update: Swedish Holding Company Linkopings Stadshus 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, Dec. 19, 2019.
- Swedish Municipalities And Regions, Dec. 3, 2019
- Sweden's Local Governments To Get A Slight Boost From 2020 Budget, Sept. 20, 2019
- S&P Global Ratings Definitions, Sept. 18, 2019
- Sweden's Municipal Sector Faces An Equalization Shake-Up, Sept. 13, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating

Transition Study, Aug. 19, 2019

- Research Update: Swedish Public Housing Company AB Stangastaden 'AA-/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, June 25, 2019.
- A Potential Profit Cap On Private Operators In Sweden's Welfare Sector Could Increase LRG Spending, March 11, 2019
- European Local And Regional Government Risk Indicators, Nov. 9, 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	
Linkoping (Municipality of)	
Issuer Credit Rating	AA+/Stable/A-1+