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Research Update:

DRAFT: Swedish Municipality of Linköping Assigned 'AA+/A-1+' Ratings; Outlook Stable

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S&PGR Rates Municipality Linköping 'AA+/A-1+'; Outlook Stable

Overview

- Despite increasing investments and pressure on operating expenditure, we expect the Municipality of Linköping to uphold moderate budgetary performance through budgetary discipline and revenue flexibility.
- After the election in September 2018, a right-center minority government will govern Linköping. As we have observed broad political consensus regarding the municipality's long-term strategy, we do not expect the new political leadership to significantly change strategy.
- We are assigning our 'AA+' long-term and 'A-1+' short-term ratings to Linköping. At the same time, we are assigning our 'K-1' short-term Nordic regional scale rating to Linköping.
- The outlook is stable.

Rating Action

On Nov. 6, 2018, S&P Global Ratings assigned its 'AA+' long-term and 'A-1+' short-term issuer credit ratings to the Swedish Municipality of Linköping. The outlook is stable.

We also assigned our 'K-1' short-term Nordic regional scale rating to Linköping.

Outlook

The stable outlook reflects our view that, over the next two years, Linköping's deficits after capital accounts will not exceed 5% of revenues, despite increasing investment and pressure on operating expenditure from demographic factors. Linköping has no direct debt, as investments are largely carried out by its fully owned companies, whereas we expect Linköping's tax-supported debt, including debt at its subsidiaries Lejonfastigheter AB (AA-/Stable/A-1+) and Linköpings Stadshus AB (AA+/Stable/A-1+), will not exceed 120% of consolidated revenues by year-end 2020.

Upside Scenario

We could consider raising the ratings on Linköping if we observed an improved debt position stemming from reduced debt levels in Linköpings Stadshus or Lejonfastigheter. We could also consider an upgrade if we observe improved cost control resulting in operating balances structurally above 5% of operating revenues.

Downside Scenario

We could consider lowering the ratings if Linköping's liquidity position deteriorated significantly, for example from a depletion of the city's liquid asset portfolio, accompanied by a worsened debt position stemming from, for example, increasing borrowings in Linköpings Stadshus and Lejonfastigheter.

Rationale

The ratings reflect our view that Linköping will maintain a sound financial position, despite pressure on operating spending and increasing investment. The resilient and diverse local economy, along with Sweden's far-reaching equalization system, supports the ratings. We expect Linköping's financial management will remain committed to budgetary discipline and counteract any pressure on the municipality's financials by utilizing its ample revenue flexibility. Linköping's liquidity position will remain exceptional, owing to its sizable long-term asset portfolio. We expect the municipality will remain debt-free over the coming years, and that tax-supported debt--including debt at holding company Linköpings Stadshus and real estate company Lejonfastigheter--will remain below 120% of consolidated revenues until year-end 2020. We also expect Linköping's contingent liabilities will remain limited.

Political consensus will support Linköping's fiscal position

We consider the institutional framework for local and regional governments (LRGs) in Sweden to be a key component in our ratings on Linköping, as it is extremely predictable and supportive and displays a high degree of stability. The sector's revenue and expenditure management is based on an extensive equalization system and autonomy in setting local taxes. As the Swedish equalization system effectively evens out differences in wealth between municipalities, we base our analysis on the Swedish three-year average GDP per capita, amounting to Swedish krona (SEK) 52,000. The local economy is strong, with Linköping being 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. Unemployment stood at 6.0% in August 2018, below both the regional average of 7.9% and national average of 7.0%. Moreover, Linköping's population has increased significantly over the past few years, averaging 1.4% annually, requiring substantial investment in core municipal infrastructure.

A right-center minority government will govern Linköping over the next four-year term. We do not foresee any major changes, as we have observed political consensus regarding, for instance, performance levels, long-term strategy, and scope of the subsidiaries' operations. We regard the city's management as prudent and committed to budgetary performance. Linköping's organizational structure comprises higher investment in the company sector, and debt is therefore situated at companies rather than at the municipality. Linköping's debt and liquidity management is decentralized, and we consider the managements of the subsidiaries to be experienced and competent. In our view, the companies are a vital public policy tool for the municipality.

Exceptional liquidity provides flexibility to deal with high company sector debt

Driven by demographic factors, Linköping's operating expenditure is set to increase, which could weigh on the municipality's operating balance. Consequently, we estimate that the operating balance will average 1.9% of operating revenues over 2019-2020, compared with 2.2% in 2017. Linköping's investments are mainly carried out by its fully owned companies, whereas the municipality's own investments relate to infrastructure, such as local roads. We expect Linköping's capital expenditure will average SEK345 million (€34 million) annually in 2019-2020, which is in line with historical levels. We anticipate Linköping will continue to post minor deficits after capital accounts averaging 0.2% of total revenues in 2019-2020, compared with a deficit of 0.5% in 2017.

In our view, Linköping has ample revenue flexibility stemming from a high share of modifiable revenues, estimated at above 70% of operating revenues. It also has a large amount of sellable assets within its company sector, where, for instance, Stångåstaden has occasionally sold assets. In addition, Linköping's long-term asset portfolio, and the relatively low municipal tax rate at 20.2%, also increases flexibility. However, we consider Swedish LRGs to have rigid operating expenditure structures, which are not easily reduced without compromising the extent and quality of mandatory public services. We expect Linköping's management will remain committed to budgetary discipline and use its revenue flexibility to counteract material pressure on the fiscal position.

Linköping's exceptional liquidity position is derived from its long-term asset portfolio, stemming from when the municipality sold the company sector to holding company, Linköpings Stadshus, a decade ago. At end-August 2018, the gross value of the portfolio was SEK7.2 billion, containing roughly 70% fixed-income related assets, with the purpose of providing Linköping with a long-term reserve. In contrast with other publicly rated LRGs in Sweden, we regard Linköping's access to external liquidity as neutral as the municipality does not have a track record of tapping the capital market directly.

The municipality of Linköping has no direct debt, as investments are mainly carried out in the company sector. In our tax-supported debt calculations, we include Lejonfastigheter and Linköpings Stadshus due to the nature of their

operations. Linköpings Stadshus governs the municipality's companies. Alongside guaranteed loans, it also holds unguaranteed debt that it onlends to other subsidiaries in the group. Lejonfastigheter provides the municipality with public service properties, such as schools and care homes, with the municipality as the main source of income. We expect tax-supported debt will remain at 108% of consolidated revenues at year-end 2020, which is on par with 2017 levels.

We consider that Linköping has low exposure to contingent liabilities. In our assessment, we include debt at Stångåstaden (AA-/Stable/A-1+) and Tekniska Verken (A+/Stable/A-1). We consider both entities to be self-supporting due to their high credit standing and focus on external clients. We consider that the companies have well-capitalized balance sheets. In addition, Stångåstaden has significant surpluses within the property portfolio. This effectively counterbalances the risks related to the companies' borrowings. Moreover, as a member of the public sector funding agency Kommuninvest, Linköping has signed a joint and several guarantee for its obligations. For now, we consider a scenario where these guarantees would be called upon as unlikely. In conclusion, we consider Linköping's contingent liabilities to be low.

Key Statistics

Table 1

| Municipality of Linköping Key Statistics | | | | | | |
|---|--------------------------------|-----------|-----------|-----------|-----------|-----------|
| | --Fiscal year ending Dec. 31-- | | | | | |
| Operating revenues | 8,747 | 9,450 | 9,926 | 10,329 | 10,739 | 11,164 |
| Operating expenditures | 8,519 | 9,277 | 9,709 | 10,126 | 10,536 | 10,954 |
| Operating balance | 228 | 173 | 217 | 203 | 203 | 210 |
| Operating balance (% of operating revenues) | 2.6 | 1.8 | 2.2 | 2.0 | 1.9 | 1.9 |
| Capital revenues | 98.0 | 151.0 | 180.0 | 130.0 | 126.0 | 116.0 |
| Capital expenditures | 221.0 | 383.0 | 447.0 | 360.8 | 344.8 | 344.8 |
| Balance after capital accounts | 105.0 | (59.0) | (50.0) | (27.8) | (15.8) | (18.8) |
| Balance after capital accounts (% of total revenues) | 1.2 | (0.6) | (0.5) | (0.3) | (0.1) | (0.2) |
| Balance after borrowings | (129.0) | (198.0) | (46.0) | (5.8) | 0.2 | 0.2 |
| Modifiable revenues (% of operating revenues) | 73.5 | 71.4 | 71.7 | 71.1 | 71.0 | 70.5 |
| Capital expenditures (% of total expenditures) | 2.5 | 4.0 | 4.4 | 3.4 | 3.2 | 3.1 |
| Tax-supported debt (outstanding at year-end) | 10,004.0 | 10,379.0 | 10,627.7 | 11,076.2 | 11,577.8 | 12,032.3 |
| Tax-supported debt (% of consolidated operating revenues) | 114.4 | 109.8 | 107.1 | 107.2 | 107.8 | 107.8 |
| Interest (% of operating revenues) | 0.4 | 0.3 | 0.7 | 0.3 | 0.3 | 0.3 |
| Local GDP per capita (single units) | N/A | N/A | N/A | N/A | N/A | N/A |
| National GDP per capita (single units) | 431,044.4 | 445,182.2 | 458,111.9 | 474,430.7 | 490,434.7 | 507,430.2 |

Table 1

Municipality of Linköping Key Statistics (cont.)

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. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc--Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

Municipality of Linköping Ratings Score Snapshot

Key rating factors

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

*The ratings of S&P Global Ratings on local and regional governments (LRGs) are based 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," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on an LRG.

Key Sovereign Statistics

- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 31, 2018

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- 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

- Sovereign Risk Indicators, July 5, 2018. An interactive version is also available at <http://www.spratratings.com/sti>
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 2018
- Increasing Capital Costs Could Test Sweden's Local Governments, Dec. 12, 2017
- S&P Global Ratings Definitions, April 19, 2018
- Swedish Public Housing Company AB Stangastaden 'AA-/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, July 6, 2018
- Swedish Real Estate Company Lejonfastigheter 'AA-/A-1+' Ratings Affirmed; Outlook Stable, March 14, 2018
- Swedish Multi-Utility Tekniska verken i Linköping Upgraded To 'A+' On Higher Likelihood Of Support From Owner, Oct. 27, 2017.
- Swedish Holding Company Linköpings Stadshus 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, Dec. 20, 2017.
- Swedish Local And Regional Government Risk Indicators: April 2017 Update, April 5, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Public Finance System Overview: Swedish Municipalities And Counties, June 15, 2017

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

New Rating

Linköping (Municipality of)

| | |
|-----------------------|-----------------|
| Issuer Credit Rating | AA+/Stable/A-1+ |
| Nordic Regional Scale | --/--/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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