

# Municipality of Nacka

August 22, 2022

This report does not constitute a rating action.

## Credit Highlights

### Overview

#### Credit context and assumptions

--Sweden's extremely predictable and supportive institutional framework underpins the ratings on Nacka.

--Solid local fundamentals and the resilient Swedish economy support strong tax-revenue growth.

--Strong budgetary discipline offsets risk from rising spending due to macroeconomic factors.

#### Base-case expectations

--Operating performance is set to normalize on the back of rising costs.

--Although borrowing costs will increase in the coming years, we believe Nacka has sufficient headroom to absorb the effect.

--Nacka's debt is set to increase on the back of capital expenditure (capex), although additional land sales might reduce its borrowing needs.

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**Rising costs will weigh on the Municipality of Nacka (Nacka)'s operating performance.** S&P Global Ratings forecasts operating costs will rise in the coming years, stemming from macroeconomic headwinds, high energy prices, and increasing pension expenditure, which will weigh on Nacka's operating performance in 2023 and 2024.

**Nacka can absorb the effects of rising interest rates.** Owing to high inflation and tighter monetary policy, we expect borrowing costs will increase through 2024. However, due to Nacka's limited debt levels and strong operating performance, we believe there is headroom to absorb this.

**Capex will remain high, although rising build costs and supply chain disruptions may delay completion.** Investments will remain elevated throughout our forecast period since Nacka needs to invest in local infrastructure to cater for its expanding population. However, we see increasing risks that key capital projects are postponed.

## Outlook

The stable outlook reflects our expectation that Nacka has budgetary headroom to manage rising cost pressures, stemming from macroeconomic factors and increasing pension costs.

### Downside scenario

We could consider a downgrade if the municipality's debt metrics deteriorate materially, while management fails to take sufficient countermeasures. This could, for instance, happen if we observe larger-than-expected debt accumulation, in combination with interest rates exceeding our expectations, leading to materially increasing interest expenditure as a share of revenue.

## Rationale

### The supportive institutional framework and resilient economy counterbalance macroeconomic challenges

Since December 2021, we have assessed Sweden's institutional framework trend as stable, versus weakening previously. We continue to regard it as 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. During the COVID-19 pandemic, the central government remained supportive of the local and regional government (LRG) sector, implementing both direct and indirect support packages to boost operating performance for Swedish municipalities. Although the Russia-Ukraine conflict will continue to affect Swedish LRGs' financial positions, both directly and indirectly, we believe the central government will remain supportive and compensate most of the sector's additional costs, similar to the 2015 European refugee crisis.

Nacka benefits from Sweden's comparably high wealth levels and resilient economy, reflected in our estimate of 2022 national GDP per capita at about \$59,200. The local economy remains strong, owing to its close integration with the Stockholm region and its favorable socioeconomic profile, illustrated, for instance, by its high income levels and a strong employment structure compared with domestic peers. We also expect Nacka's population growth will remain above the national average, supporting strong tax-revenue growth.

The political situation in Nacka is stable. It is currently governed by a center-right majority government. We do not expect the September elections to disrupt Nacka's operations or strategies. The municipality has a track record of prudently managing its expenditure and implementing necessary policy reforms, and the quality of its provided services is high in a domestic comparison. In addition, we believe its risk management is conservative, illustrated by risk minimizing debt and liquidity policies, although we regard the municipality's decision to not hedge its energy exposures as less prudent.

### Nacka will absorb rising borrowing costs due to its limited debt burden and strong performance

We forecast Nacka will post strong, yet gradually weakening, operating performance over the next two years. In our view, tax-revenue growth will remain strong through 2024 on the back of solid population growth, which will contribute to strong performance in 2022 since operating spending has been restrained because of the pandemic. However, we believe performance is set to normalize in 2023-2024 as demand for welfare services returns to normal and high energy prices and inflation spur expenditure growth. In addition, pension costs are set to rise because of the new agreement for public employees in 2023. Nevertheless, we expect the municipality to remain committed to budgetary discipline and address any major pressure to comply with its internal surplus target, yielding relatively strong S&P Global Ratings-defined operating balances.

Although Nacka's strong cash generation will ensure a strong balance after capital accounts in 2022, we expect deficits to widen in 2023 and 2024 as capex increases and internal cash generation weakens. The municipality is required to undertake certain investments and prepare for new construction of housing related to the subway network's extension in Stockholm. We expect capital revenue will remain fairly high throughout the forecast period, primarily from selling land and real estate. Historically, Nacka has managed to contain its debt burden due to asset sales being higher than expected. We have conservatively forecast asset sales but acknowledge that borrowing needs could further reduce should they materialize at higher amounts.

## Municipality of Nacka

In addition to the municipality's own investments of Swedish krona (SEK) 3.5 billion over the forecast period, we estimate Nacka's relatively small company sector will require approximately SEK390 million of debt funding from the in-house bank through 2024. This is almost exclusively related to the fully owned water and waste company Nacka Vatten och Avfall AB. In addition, we understand that the jointly owned wastewater treatment association Käppalaförbundet has made a strategic decision to gradually refinance existing debt and fund future investments through on-lending from its owners, starting 2022. We expect this arrangement will add about SEK180 million of additional debt for Nacka through 2024.

We therefore expect Nacka will add SEK370 million per year on average through 2024 to its debt burden, which apart from its direct debt also includes extended guarantees of about SEK45 million. We currently do not expect its debt burden to surpass 30% of consolidated revenue, including external revenue from the companies. We estimate that almost 60% of total debt will be on-lent to the water and waste company by 2024, which under current legislation has the power to adjust user fees to offset cost increases and recover investments made.

We forecast that the average interest rate of Nacka's debt portfolio will increase more than 5x through 2024 compared to the past two years. In combination with rising debt levels, this will result in higher interest expenses. In our view, Nacka has ample headroom to absorb these additional expenses owing to its limited debt burden and relatively strong performance, and we do not expect interest expenditure will exceed 1% of revenue over the forecast period.

The municipality's liquidity position remains exceptional, owing to the ample amount of contracted liquidity facilities, which we estimate will cover considerably more than 120% of upcoming average annual debt service, alongside the municipality's strong access to capital markets. Nacka does not have any commercial paper borrowings outstanding, which, combined with a relatively small debt burden, leaves limited annual refinancing needs. We expect a pickup in commercial paper borrowings over the coming two years, but not enough to materially pressure the liquidity coverage ratio.

We include SEK2.5 billion of cash and committed backup facilities as liquidity sources. We also estimate the municipality has upcoming borrowing needs averaging about SEK170 million, and will service almost SEK450 million of maturing debt and interest on average, over the coming 12 months.

### Municipality of Nacka Selected Indicators

Mil. SEK	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenue	6,857	7,250	7,488	7,697	7,932	8,301
Operating expenditure	6,582	6,816	6,890	7,109	7,571	7,913
Operating balance	275	434	598	588	361	388
Operating balance (% of operating revenue)	4.0	6.0	8.0	7.6	4.6	4.7
Capital revenue	879	852	245	380	520	650
Capital expenditure	1,153	991	878	970	1,183	1,358
Balance after capital accounts	1	295	(35)	(2)	(303)	(319)
Balance after capital accounts (% of total revenue)	0.0	3.6	(0.5)	(0.0)	(3.6)	(3.6)
Debt repaid	900	650	0	550	350	700
Gross borrowings	1,400	600	0	650	800	1,260
Balance after borrowings	(108)	275	(165)	(96)	(102)	(4)
Direct debt (outstanding at year-end)	1,400	1,350	1,350	1,450	1,900	2,460
Direct debt (% of operating revenue)	20.4	18.6	18.0	18.8	24.0	29.6

## Municipality of Nacka

### Municipality of Nacka Selected Indicators

Tax-supported debt (outstanding at year-end)	1,439	1,387	1,389	1,495	1,945	2,505
Tax-supported debt (% of consolidated operating revenue)	20.2	18.4	17.8	18.2	23.0	28.4
Interest (% of operating revenue)	0.1	0.1	0.1	0.2	0.5	0.8
Local GDP per capita (\$)	--	--	--	--	--	--
National GDP per capita (\$)	52,186.7	52,970.2	61,302.8	59,177.2	63,590.8	68,804.9

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. \$--U.S. dollar.

### Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	1
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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, July 11, 2022. An interactive version is available at [www.spratings.com/SRI](http://www.spratings.com/SRI)

### Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

## Municipality of Nacka

- 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

- Institutional Framework Assessments For International Local And Regional Governments, July 26, 2022
- Southern Swedish LRGs Bear The Brunt Of Surging Electricity Prices, July 20, 2022
- Sweden, May 2, 2022
- Swedish Local Governments Are Holding Up Against Cyber Attacks, Jan. 26, 2022
- Swedish Municipalities And Counties, Dec. 13, 2021

## Ratings Detail (as of August 22, 2022)\*

### Municipality of Nacka

Issuer Credit Rating AAA/Stable/A-1+

### Issuer Credit Ratings History

12-Dec-2018 AAA/Stable/A-1+

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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