

## Municipality of Nacka

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**Table Of Contents**

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Key Rating Factors

Outlook

Rationale

Key Statistics

Ratings Score Snapshot

Key Sovereign Statistics

Related Criteria

Related Research

# Municipality of Nacka

This report does not constitute a rating action.

## Key Rating Factors

Issuer Credit Rating
AAA/Stable/A-1+
Nordic Regional Scale
--/--/NR

Credit context and assumptions	Base-case expectations
<p><i>Supportive central government and strong socioeconomic characteristics mitigate risks related to the COVID-19 pandemic.</i></p> <ul style="list-style-type: none"> <li>Sweden's central government has provided extensive support in response to the pandemic, including increased grant transfers, COVID-19-related expenditure compensation, and amendments to the furlough schemes, which has shielded tax-revenue growth.</li> <li>Nacka's resilient local economy and very favorable socioeconomic profile could, in our view, spur swift recovery once the virus is contained.</li> <li>We believe these factors, in combination with prudent expenditure management, will mitigate the impact from the pandemic on Nacka's fiscal position over the coming two years.</li> </ul>	<p><i>Strong operating performance and large capital revenue help contain debt accumulation caused by high investments.</i></p> <ul style="list-style-type: none"> <li>Nacka's sound operating performance is underpinned by generous support from the central government and implemented efficiency measures.</li> <li>The city is set to contain its debt burden through substantial inflows of capital revenue, while executing large investments.</li> <li>That said, uncertainty through the forecast period remains high, and that a worsened macroeconomic situation could weaken Nacka's fiscal position.</li> </ul>

## Outlook

The stable outlook reflects our expectation that Nacka will weather the impact of the COVID-19 pandemic and uphold sound operating performance over the coming years. In addition, we anticipate that Nacka's debt, although increasing, will likely remain lower than that of many other Swedish municipalities we rate. Furthermore, we expect Nacka to maintain exceptionally strong liquidity, alongside conservative and prudent financial policies.

## Downside scenario

We could consider a downgrade if Nacka's debt increased significantly beyond our projections and we expected this situation to become permanent, without the city's management taking sufficient measures to stem debt growth. We could also lower the rating if we revised down our view of the institutional framework for Swedish local and regional governments (LRGs).

## Rationale

We forecast Nacka will post relatively strong operating performance over the coming two years, owing to extensive central government support, including increased grant transfers, and stronger tax-revenue growth than we expected six months ago. This, in combination with large inflows from asset sales, will enable Nacka to amortize debt in 2020, and accumulate liquid asset reserves for upcoming investments. Consequently, we anticipate a less dramatic increase in debt than we did in our last review, although we still expect it to increase through 2022. Furthermore, we expect Nacka will maintain its favorable liquidity position, supported by ample reserves of contracted facilities and strong access to external financing.

### **Political stability, strong ties to the dynamic Stockholm region, and government support mitigates risks from the pandemic, although long-term risks remain**

We consider the institutional framework to be generally supportive of Swedish LRGs, but that it is on a weakening trend. In recent years, the sector's budgetary performance has deteriorated due to increasing expenditure--accentuated by central government policymaking--alongside insufficient central government compensation mechanisms and inadequate countermeasures by the LRGs. Nevertheless, we believe the institutional framework remains a key credit strength for Swedish LRGs. In our view, the framework displays a high degree of stability, and the sector's revenue and expenditure management are both based on a far-reaching equalization system and autonomy in setting local taxes. The central government's swift response to the COVID-19 pandemic, illustrated, for instance, by extraordinary grants, supports our opinion.

The political landscape in Nacka is stable, with a right-center majority administration in place. The political leadership, in tandem with the team of civil servants, has a track record of prudently manage its expenditure and implementing necessary policy reforms. In addition, we regard Nacka's treasury management as risk minimizing, illustrated by very conservative debt and liquidity policies.

Nacka benefits from Sweden's comparably high wealth, reflected in our estimate of 2020 national GDP per capita at about \$52,000. To date, the capital region of Stockholm, of which Nacka is a suburb, has been hardest hit by the pandemic in Sweden. Nacka's unemployment has risen to 6.5% as of October 2020 from 4.5% at year-end 2019. We believe the local economy remains strong and resilient, however, owing to its close integration with the Stockholm region, and its favorable socioeconomic profile, which we believe will be key in the recovery after the pandemic.

### **Central government support packages will compensate for revenue shortfalls due to COVID-19**

We now expect Nacka will post stronger, yet gradually worsening, operating results through 2022, compared with the past two years, as Nacka benefits from increased grant transfers and relatively strong tax-revenue growth. We forecast lower operating spending growth in 2020, and that the central government will compensate for certain COVID-19

related expenditure. Consequently, we believe Nacka will post very strong results in 2020. We believe grants will gradually reduce over the forecast period. The municipality has decided to reduce the local tax rate to 18.23% from 18.43% from 2021, both factors leading to slower growth of operating revenue in 2021 and 2022. This, combined with higher operating spending partly related to higher welfare expenditure, will weigh on Nacka's operating margin. Furthermore, we believe that Nacka's budget could come under pressure should the macroeconomic situation worsen more than we currently expect.

Nacka's relatively high population growth, in combination with demographic changes, will require high investments in the coming years. For instance, Nacka is required to undertake certain investments and prepare for new construction of housing in relation to the extension of the subway network in Stockholm. We expect capital revenue will remain high throughout the forecast period, primarily from selling land and real estate. Despite the pandemic, we note that Nacka's asset sales are proceeding according to plan, with little impact from COVID-19 so far. Weakened economic conditions could impair Nacka's ability to divest assets and contain debt, should the recovery lag expectations.

In addition to the municipality's own investments, Nacka's relatively small company sector, mainly related to its water company (Nacka Vatten och Avfall AB), has relatively large upcoming investments that require debt financing from the municipality's in-house bank. Consequently, we believe Nacka's funding needs are relatively large over the coming two years. However, owing to unexpectedly strong cash generation in 2020, Nacka has built liquidity buffers, which we expect it will use to partly finance these investments and limit its borrowing needs over the next two years.

Consequently, we forecast a less dramatic debt accumulation than we did six months ago. We still forecast Nacka's tax-supported debt, which includes debt and extended guarantees, will increase through 2022. Moreover, owing to the water company's business profile and financial position, we consider it a mitigant to Nacka's total debt burden. Adjusted for the water company, we estimate Nacka's tax-supported debt would be less than 10% of consolidated revenue.

The liquidity position remains very strong, owing to the ample amount of contracted liquidity facilities, which we estimate will cover considerably more than 120% of upcoming average-12-months debt service, alongside the municipality's strong access to the capital markets. During 2020, Nacka has repaid all outstanding commercial paper (CP), which has reduced its refinancing needs. We believe it will start issuing CP again in 2021, and gradually increase the share of CP as its debt increases. Despite this, we expect the liquidity cover ratio will remain exceptionally strong through 2023.

We include Swedish krona (SEK) 2.4 billion of cash, liquid financial assets (including an appropriate haircut), and committed backup facilities and checking accounts, as liquidity sources. We estimate the municipality has upcoming borrowing needs of about SEK75 million-SEK80 million, excluding its owned companies, and we expect Nacka will service SEK98 million of maturing debt and interest on average over the coming 12 months.

## **Key Statistics**

**Table 1**

<b>Municipality of Nacka -- Selected Indicators</b>						
	<b>--Fiscal year end Dec. 31--</b>					
<b>(Mil. SEK)</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020bc</b>	<b>2021bc</b>	<b>2022bc</b>
Operating revenues	6,530	6,540	6,857	6,917	7,006	6,888
Operating expenditures	6,175	6,256	6,582	6,529	6,643	6,581
Operating balance	355	284	275	388	363	307
Operating balance (% of operating revenues)	5.4	4.3	4.0	5.6	5.2	4.5
Capital revenues	633	132	879	631	464	419
Capital expenditures	793	935	1,153	787	1,032	991
Balance after capital accounts	195	(519)	1	232	(205)	(264)
Balance after capital accounts (% of total revenues)	2.7	(7.8)	0	3.1	(2.7)	(3.6)
Debt repaid	161	700	900	250	77	674
Gross borrowings	0	1,350	1,400	200	474	1,051
Balance after borrowings	15	93	(108)	16	(63)	(142)
Direct debt (outstanding at year-end)	250	900	1,400	1,350	1,746	2,124
Direct debt (% of operating revenues)	3.8	13.8	20.4	19.5	24.9	30.8
Tax-supported debt (outstanding at year-end)	291	943	1,439	1,350	1,746	2,124
Tax-supported debt (% of consolidated operating revenues)	4.3	13.9	20.2	18.8	23.9	29.5
Interest (% of operating revenues)	0.5	0	0.1	0.1	0.1	0.1
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	462,734	477,094	490,830	476,155	498,873	518,632

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**

<b>Municipality of Nacka -- Ratings Score Snapshot</b>	
<b>Key rating factors</b>	<b>Score</b>
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, Oct. 12, 2020. An interactive version is available via [www.spratings.com/sri](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: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Dec. 1, 2020
- Extra funding in Sweden's 2021 Budget will Support LRGs, Sept. 24, 2020
- European Local And Regional Government Risk Indicators, June 30, 2020
- COVID-19: Fiscal Response Will Lift Local And Regional Government Borrowing To Record High, June 9, 2020
- COVID-19 Could Further Strain Swedish LRGs' Budgets, May 20, 2020
- Swedish Government To Mitigate Impact From Coronavirus On Local And Regional Governments, March 11, 2020
- Public Finance System Overview: Swedish Municipalities And Regions, Dec. 3, 2019
- Sweden's Local Governments To Get A Slight Boost From 2020 Budget, Sept. 20, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019

### Ratings Detail (As Of December 7, 2020)\*

#### Municipality of Nacka

Issuer Credit Rating	AAA/Stable/A-1+
<i>Nordic Regional Scale</i>	--/--/NR

#### Issuer Credit Ratings History

12-Dec-2018		AAA/Stable/A-1+
14-Dec-2018	<i>Nordic Regional Scale</i>	--/--/NR
12-Dec-2018		--/--/K-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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