

Research Update:

Swedish Municipality of Nacka Ratings Affirmed At 'AAA/A-1+'; Outlook Stable

December 6, 2019

Overview

- Nacka's budgetary performance will likely come under increased pressure over the next two years, partly owing to lower tax revenue growth and partly to the revised cost equalization system, which will be implemented in 2020.
- Although strong population growth has increased Nacka's investment needs, we expect its debt burden to remain manageable, supported by continued asset sales in the coming years.
- We are affirming our 'AAA/A-1+' ratings on Nacka.
- The outlook is stable.

Rating Action

On Dec. 6, 2019, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the Swedish Municipality of Nacka. The outlook is stable.

Outlook

Nacka's budgetary performance is likely to remain stable, but weaker than in 2017, even though operating expenditure will come under pressure and tax revenue growth will be lower. Nacka onlends a significant share of its debt to its regulated water company. We expect the increase in its debt to remain low compared with many other rated municipalities. Furthermore, we expect that management will uphold the exceptionally strong liquidity position and adhere to the conservative and prudent financial policies.

We could consider a downgrade if management fails to comply with Nacka's targets on self-financing, causing debt to materially increase and prompting us to revise down our debt assessment. We could also lower the rating if we revised down our view of the institutional framework for Swedish local and regional governments (LRGs).

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Rationale

Nacka's budgetary performance is likely to remain sound, even though pressure on operating expenditure and lower tax revenue growth will likely lead to weaker operating balance margins in the forecast period. We anticipate that Nacka's experienced financial management will contain debt accumulation, although strong population growth is causing investment needs to rise. Nacka's close integration with the Stockholm region's diversified labor market supports its high income levels. We also expect Nacka to maintain its favorable liquidity position, supported by ample reserves of contracted facilities and strong access to external financing.

Political stability and strong ties to the vibrant Stockholm region support Nacka's financial position

The institutional framework forms a key component of our ratings on Swedish LRGs. The system is supported by a far-reaching equalization system that evens out differences in wealth between municipalities and regions, and full autonomy over the local tax rate. The framework also displays a high degree of institutional stability and transparency, in part because the balanced budget requirement supports financial stability in the LRG sector. Even though the framework has no penalties for noncompliance, the requirement gives LRGs an incentive to maintain sound budgetary discipline and strict cost control.

That said, the sector's performance is deteriorating because LRGs are neither receiving adequate compensation from the central government nor implementing countermeasures sufficient to offset their increasing expenditure. Consequently, we now see a weakening trend for the institutional framework, rather than stable.

The political landscape in Nacka remains stable. Right-wing party Moderaterna is still the largest, after decades as the dominant party. In our view, the political leadership in Nacka displays a strong track record of adherence to long-term financial strategies, combined with broad consensus on the municipality's priorities. For example, the political parties agree on the importance of education and subscribe to the municipality's ambitious goal of providing the best schools in the world to its children. Communication between politicians and civil servants is efficient and transparent, leading to improved decision-making capacity in times of financial adversity.

Nacka benefits from its proximity to Stockholm--a relatively high proportion of the population is highly educated and earns high incomes. The strong socioeconomic profile is demonstrated by Nacka's healthy population growth, and unemployment and income levels are stronger than regional and national levels. Nacka's economic position is supported by Sweden's stable and wealthy economy--GDP per capita is estimated at \$52,000 in 2019.

Changes to the equalization system and weaker tax revenue growth have strained Nacka's budgetary performance, but liquidity position remains very strong

From 2020, the Swedish government will introduce amendments to the cost equalization system aimed at evening out more of the structural cost differences between LRGs. Given the municipality's favorable financial position, Nacka will have to contribute an additional Swedish krona (SEK) 38 million to the system each year. To ease the burden, Nacka will receive a

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compensation grant amounting to SEK38 million in 2020, but in 2021, the annual contribution will take full effect and will undermine the municipality's budgetary performance.

In addition, macroeconomic data indicate that Sweden is entering a period of lower economic activity, causing tax revenue to fall in 2020-2021. Like many other LRGs in Sweden, Nacka is affected by demographic pressure. However, Nacka has implemented an ambitious cost savings plan, clearly specifying areas in which its municipal departments must cut back on expenses to reach its financial goals. We forecast that the operating balance margin will remain below 5% through 2021, resulting in an average of 4.9% through 2017-2021, compared with 5.1% in our previous review.

Nacka's extensive investment needs are based on strong population growth, combined with an increase in the proportion of residents that are not of working age (either under 19 years or over 65 years). However, much of Nacka's growth stems from an influx of working-age citizens. This limits the effect of a rising share of elderly residents on the municipality. The municipality is also preparing for the metro extension, which will improve the connection between Nacka and the center of Stockholm. At the same time, we expect capital revenue to remain high throughout the forecast period, primarily because the municipality will make land development gains and divest real estate.

Nacka's relatively small company sector comprises a water company and an energy company, of which only the former will require financing from the municipality's in-house bank in 2019-2021. In our view, onlending to the regulated and financially stable water company mitigates Nacka's debt burden. Most of the centralized in-house bank's upcoming borrowings will stay in the municipality, enabling Nacka to fulfil its ambitious investment targets.

Consequently, we expect Nacka's debt burden to increase gradually in the coming years. We forecast that tax-supported debt will reach 33% of consolidated operating revenues in 2021, from 13% in 2018. In addition to the municipality's interest-bearing debt, we also include guarantees to the energy company, sporting organizations, etc., in our tax-supported debt figures. However, the exposure remains insignificant compared with outstanding debt and the municipality does not have any additional contingent liabilities. Also, we consider the risk of materialization as low.

Nacka's liquidity position remains very strong and it has ample sources of contracted facilities. Nacka can access a SEK1 billion checking account and two SEK750 million committed facilities. The municipality's next long-term bond maturity takes place in 2022, meaning that the only short-term maturities at this point are commercial paper. Even though we expect outstanding commercial paper to increase somewhat, the liquidity ratio will remain exceptionally high, given unchanged volumes of contracted facilities. We estimate the weighted liquidity coverage ratio at 633%, comfortably above the 120% threshold. Furthermore, in line with other rated Swedish LRGs, we view Nacka's access to external liquidity as strong, with readily available sources of financing. Nacka's financing comes exclusively from a SEK4 billion commercial paper program and a SEK4 billion medium-term note program, which allows for issuance of green bonds.

Key Statistics

Table 1

Municipality of Nacka Selected Indicators

Mil. SEK	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	6,357	6,530	6,540	6,807	7,037	7,194
Operating expenditures	5,989	6,175	6,256	6,472	6,689	6,861

Table 1

Municipality of Nacka Selected Indicators (cont.)

Mil. SEK	2016	2017	2018	2019bc	2020bc	2021bc
Operating balance	368	355	284	335	348	333
Operating balance (% of operating revenues)	5.8	5.4	4.3	4.9	4.9	4.6
Capital revenues	978	633	133	440	498	523
Capital expenditures	795	793	935	1,044	1,035	1,063
Balance after capital accounts	551	195	(518)	(269)	(190)	(206)
Balance after capital accounts (% of total revenues)	7.5	2.7	(7.8)	(3.7)	(2.5)	(2.7)
Debt repaid	289	161	700	250	350	450
Gross borrowings	0	0	1,350	730	911	971
Balance after borrowings	(216)	15	93	92	(150)	(0)
Direct debt (outstanding at year-end)	411	250	900	1,380	1,941	2,462
Direct debt (% of operating revenues)	6.5	3.8	13.8	20.3	27.6	34.2
Tax-supported debt (outstanding at year-end)	451	291	943	1,424	1,986	2,507
Tax-supported debt (% of consolidated operating revenues)	7.1	4.2	13.6	19.7	26.6	32.8
Interest (% of operating revenues)	0.8	0.6	0.2	0.4	0.5	0.6
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	448,258	462,329	477,624	490,354	500,894	514,643

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 Nacka 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

Table 2

Municipality of Nacka Ratings Score Snapshot (cont.)

Key rating factors	Scores
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. 10, 2019. An interactive version is available at 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

- Swedish Municipalities And Regions, Dec. 3, 2019
- S&P Global Ratings Definitions, July 5, 2019
- Sweden's Local Governments To Get A Slight Boost From 2020 Budget, Sept. 20, 2019
- Sweden's Municipal Sector Faces An Equalization Shake-Up, Sept. 13, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- A Potential Profit Cap On Private Operators In Sweden's Welfare Sector Could Increase LRG Spending, March 11, 2019
- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 22, 2019
- Public Finance System Overview: Swedish Municipalities And Counties, Jan. 21, 2019
- European Local And Regional Government Risk Indicators, Nov. 9, 2018
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 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

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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

Municipality of Nacka

Issuer Credit Rating AAA/Stable/A-1+

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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