

Research Update:

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

June 5, 2020

## Overview

- We expect COVID-19 to lead to lower tax revenue for Nacka through 2022, despite additional central government grants to ease budgetary pressure stemming from the pandemic.
- We forecast that Nacka's operating balances will average 3.8% in 2020-2021, down from 4.2% in 2018-2019.
- Nacka's tax-supported debt is increasing, and we project it will reach 46% of consolidated operating revenue in 2022 versus 20% in 2019, largely due to financing for its self-supporting companies.
- We are affirming our 'AAA/A-1+' ratings on Nacka and maintaining a stable outlook.

## Rating Action

On June 5, 2020, 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

The stable outlook reflects our expectation that Nacka's budgetary performance is likely to weaken only slightly due to lower tax revenue growth stemming from COVID-19 and higher operating expenditure. We anticipate that Nacka's debt, although increasing, should remain lower than that of many other rated Swedish municipalities. 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 materially 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

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institutional framework for Swedish local and regional governments (LRGs).

## **Rationale**

Nacka's budgetary performance is likely to weaken slightly over 2020-2021 due to falling tax revenue as a result of COVID-19. We observe, however, that the central government has announced an additional support package for the Swedish municipal sector, which should mitigate the negative impact on Nacka's budgetary performance. We also anticipate that Nacka's experienced financial management will contain debt accumulation, despite rising investment needs on the back of strong population growth. 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 dynamic Stockholm region support Nacka's financial position**

The institutional framework is a key component of our ratings on Swedish LRGs. The framework is supported by a far-reaching equalization system that evens out differences in wealth between municipalities and regions, and LRGs have 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 does not envisage penalties for noncompliance, the requirement gives LRGs an incentive to maintain sound budgetary discipline and strict cost control.

That said, despite these strengths, the sector's performance is gradually deteriorating because LRGs are facing higher expenditure due to demographic pressures, which have so far not been sufficiently offset by central government funds or by LRGs' additional measures. Consequently, we believe the institutional framework is weakening.

The political landscape in Nacka remains stable. Right-wing 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 sticking to its long-term financial strategies, and there is broad consensus on the municipality's priorities. Communication between politicians and civil servants is efficient and transparent, leading to robust decision-making in times of financial adversity.

Nacka benefits from its proximity to Stockholm, and a relatively large proportion of the population is highly educated and earns high income. This strong socioeconomic profile is demonstrated by Nacka's sustained population growth, as well as by lower unemployment and higher income levels than the regional and national average. Nacka's economic position is supported by Sweden's stable and wealthy economy, with the national GDP per capita estimated at \$48,000 in 2020.

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

We project that Nacka's operating balances will weaken only slightly over 2020-2022 due to falling tax revenue as a result of COVID-19. This is because the central government is providing additional state transfers to the municipal sector, which will somewhat mitigate the negative impact on budgetary performance. Like many other LRGs in Sweden, Nacka is also affected by demographic changes. However, the municipality has implemented an ambitious cost-savings plan, clearly

specifying areas where municipal departments must rationalize costs to achieve its financial goals. We forecast that the operating balance will remain below 5% of operating revenue through 2022, and average 4% in 2018-2022.

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. Nacka is also preparing for the extension of the underground rail network, 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 sell real estate.

Nacka's relatively small company sector comprises a water company and an energy company that will require financing from the municipality's in-house bank in 2020-2022. Most of the proceeds of Nacka's debt will be onlent to the regulated and financially stable water company, which we consider mitigates Nacka's debt burden. Consequently, we expect Nacka's debt will increase gradually in the coming years mainly due to financing needs of its companies. We forecast that tax-supported debt will reach 46% of consolidated operating revenues in 2022, up from 20% in 2019. In addition to the municipality's interest-bearing debt, we include guarantees, for example to sporting organizations, in our tax-supported debt figure. However, exposure to guarantees remains insignificant compared with outstanding debt, and the municipality does not have any additional contingent liabilities. Also, we consider the risk of materialization low.

The liquidity position remains very strong. Nacka has ample contracted liquidity facilities, with access to a Swedish krona (SEK) 1 billion checking account and two SEK750 million committed facilities. The municipality's first upcoming bond maturity is in 2022, meaning that the only short-term debt at this point comprises commercial paper. Even though we expect outstanding commercial paper to increase somewhat, the debt-service coverage ratio should remain exceptionally high, given unchanged volumes of contracted facilities. We estimate that Nacka has liquidity facilities sufficient to cover its debt service by about 9x on average over 2020 and 2021. Furthermore, in line with other rated Swedish LRGs, we believe Nacka has strong access to external liquidity, as shown by its success in tapping its SEK4 billion commercial paper program and SEK4 billion medium-term note program.

## Key Statistics

Table 1

### Municipality of Nacka Selected Indicators

Mil. SEK	--Fiscal year end Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenue	6,530	6,540	6,857	6,880	6,939	7,070
Operating expenditure	6,175	6,256	6,582	6,632	6,680	6,781
Operating balance	355	284	275	248	259	289
Operating balance (% of operating revenue)	5.4	4.3	4.0	3.6	3.7	4.1
Capital revenue	633	133	879	400	400	400
Capital expenditure	793	935	1,153	823	857	849
Balance after capital accounts	195	(518)	1	(175)	(198)	(160)

Table 1

**Municipality of Nacka Selected Indicators (cont.)**

Mil. SEK	--Fiscal year end Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Balance after capital accounts (% of total revenue)	2.7	(7.8)	0.0	(2.4)	(2.7)	(2.1)
Debt repaid	161	700	900	250	150	950
Gross borrowings	0	1,350	1,400	1,054	698	1,610
Balance after borrowings	15	93	(108)	50	(0)	0
Direct debt (outstanding at year-end)	250	900	1,400	2,204	2,752	3,412
Direct debt (% of operating revenue)	3.8	13.8	20.4	32.0	39.7	48.3
Tax-supported debt (outstanding at year-end)	291	943	1,439	2,243	2,791	3,451
Tax-supported debt (% of consolidated operating revenue)	4.2	13.6	19.7	30.5	37.6	45.7
Interest (% of operating revenue)	0.6	0.2	0.3	0.6	0.6	0.7
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 Nacka Ratings Score Snapshot**

Key rating factors	Score
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, April 24, 2020

## **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**

- 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
- Local Government Debt 2020: Low Growth And High Refinancing Are Fueling European Borrowing, March 2, 2020
- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable, Feb. 14, 2020

Public Finance System Overview: Swedish Municipalities And Regions, Dec. 3, 2019

- S&P Publishes 2020 Outlook For Local And Regional Governments Outside The U.S., Nov. 18, 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
- 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

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.

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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

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#### Municipality of Nacka

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Issuer Credit Rating AAA/Stable/A-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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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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