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Research Update:

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

Primary Credit Analyst:

Carina Redelius, Stockholm (46) 8-440-5918; carina.redelius@spglobal.com

Secondary Contact:

Carl Nyrrerod, Stockholm (46) 8-440-5919; carl.nyrrerod@spglobal.com

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(**Editor's Note:** On Dec. 14, 2018, we withdrew our Nordic regional scale rating on Nacka, which was erroneously assigned. We have amended the text below accordingly.)

Overview

- We project that Nacka will expand rapidly over the coming years due to strong population growth, with its solid economic fundamentals, budgetary performance, and financial flexibility keeping debt growth in check.
- Nacka's government remained in power after the September elections, so we see strong political stability in the municipality and no signs of significant changes in long-term strategy or priorities.
- We are assigning our 'AAA/A-1+' ratings to Nacka, with a stable outlook on the long-term rating.

Rating Action

On Dec. 12, 2018, S&P Global Ratings assigned its 'AAA' long-term and 'A-1+' short-term issuer credit ratings to the Swedish Municipality of Nacka. The outlook is stable.

Outlook

The stable outlook reflects our view that, over the next two years, Nacka's deficits after capital accounts will not exceed 5% of revenues on average, despite increasing investment and pressure on operating expenditure from demographic factors. We expect Nacka's tax-supported debt, including debt at its subsidiaries, will not exceed 30% of consolidated revenues by year-end 2020. Furthermore, we assume that Nacka will stick to its current conservative approach to managing liquidity coverage.

Downside scenario

We could consider lowering the ratings if Nacka's budgetary performance deteriorated significantly, for example due to looser revenue and expenditure management, alongside higher debt stemming from a significant increase in borrowing as a result of lower operating balances and management not using its revenue flexibilities. This scenario could also include worsening of the liquidity coverage ratio because of higher volumes of maturing debt or a

reduction in the amount of liquidity facilities. If Nacka did not use its revenue flexibility to counteract significant deteriorations in budgetary performance or pursued a riskier debt and liquidity management strategy, we could take a more negative view of its management.

However, we view these scenarios as unlikely over our forecast period.

Rationale

The ratings reflect our view that Nacka will maintain a sound financial position, despite pressure on operating spending and increasing investments stemming from its rapidly expanding population. We believe that Nacka's resilient and diverse economy, with very low unemployment, further supports the ratings. We expect Nacka's financial management will remain committed to budgetary discipline to counteract any pressure on the municipality's financial position. We believe Nacka's liquidity will remain exceptionally strong, owing to its sizable committed facilities and only limited amount of maturing debt. We expect tax-supported debt will remain below 30% of consolidated revenues until year-end 2020. Given its small municipal company sector, Nacka's contingent liabilities will remain small, in our view.

We expect that political consensus will support Nacka's fiscal position.

We consider the institutional framework for local and regional governments (LRGs) in Sweden to be a key component of our ratings on Nacka, since 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 LRGs' autonomy in setting local taxes. Because the Swedish equalization system effectively evens out differences in wealth between the municipalities, we base our analysis on Sweden's three-year average GDP per capita of Swedish krona (SEK) 475,000 (about \$52,000).

The local economy is strong, with Nacka situated within Stockholm County. Business sectors in Nacka are well diversified, with a marked presence of retail, IT and media, financial industry, and corporate services. In addition, Nacka is an administrative center and the location of many Scandinavian companies' headquarters. The unemployment rate in Nacka stood at 4.8% in October 2018, below the regional average of 5.8% and national average of 6.9%. Nacka's population has increased over the past three years, by 1.7% annually on average, and we expect it will expand by more than 2% annually over the coming years. The population is projected to reach 140,000 by 2030 and require an estimated 20,000 new apartments, as well as substantial investment in core municipal infrastructure averaging about SEK1 billion yearly. Nacka borders central Stockholm and is viewed as an attractive municipality to live in, as reflected for example in high house prices, which are 295% the national average and 126% of the Stockholm average. Income levels in Nacka are also higher than the national average, which results in a stronger-than-average tax

base.

Nacka's conservative Alliance-majority government will continue to govern over the next four-year term. We have historically observed stable political leadership and performance levels, adherence to long-term strategies, and few changes to the municipal companies' operations. We regard the municipality's management as prudent and committed to budgetary performance and debt sustainability, as exemplified by adjustments in its local tax rate over previous years, and when the municipality sold some of its assets in 2017 and amortized almost all of its debt.

Strong budgetary performance and financial flexibility will likely curb debt growth.

We estimate that Nacka's operating balance will average 5.6% of operating revenues over 2019-2020, compared with 5.4% in 2017. Due to the rapid population growth, Nacka's investments are high and mainly centered on schools, kindergartens, elderly care homes, and infrastructure. We expect Nacka's capital expenditures will average SEK1 billion annually in 2019-2020, which is in line with the levels in 2017-2018. We anticipate that Nacka will post a deficit after capital accounts of 3.5% of total revenues in 2019, but return to balanced levels in 2020 after it sells some of its large land holdings.

In our view, the high average income levels and strong tax base provide Nacka with ample revenue flexibility, stemming from a high share of modifiable revenues. At year-end 2017, Nacka's modifiable revenues represented about 84% of operating revenues, which is one of the highest shares among its rated peers. In addition, Nacka's municipal tax rate is 18.43%, which is the seventh lowest municipal tax in Sweden. We note that Nacka has increased and decreased the tax rate over the years. We believe Nacka's ability and willingness to increase revenues by raising the tax rate further strengthens its financial flexibility. Furthermore, the municipality owns a large amount of valuable and easily sellable land, which it occasionally divests to fund investments. However, we consider Swedish LRGs to have rigid operating expenditure, which they cannot easily reduce without compromising the extent and quality of mandatory public services. We expect Nacka's management will remain committed to budgetary discipline and use its revenue flexibility to counteract material pressure on budgetary performance and debt levels.

Nacka's exceptional liquidity stems from having ample committed bank facilities and very low maturing debt. Furthermore, we consider that Nacka, in line with rated Swedish peers, has strong access to the capital market, which we believe reinforces its liquidity position.

In our calculation of Nacka's tax-supported debt, we include debt onlent to the municipal companies and their revenues. We note that Nacka has previously sold assets and used the proceeds to amortize debt, such that it was almost debt-free in 2017. With borrowings forecast to increase, tax-supported debt could rise to 27% of consolidated operating revenues in 2020 from 4% in 2017.

However, we note that Nacka will likely lend the proceeds of about half of the total debt at year-end 2020 to its self-supporting water company, which we view as positive for the municipality's overall debt position.

We consider that Nacka has very low contingent liabilities. The municipal company sector is very small, as are guarantees, which we already factor into our assessment of tax-supported debt. Furthermore, Nacka is not a member of Kommuninvest and therefore has no obligation to support the agency.

Key Statistics

Table 1

Municipality of Nacka Selected Indicators						
	--Fiscal year end Dec. 31--					
(Mil. SEK)	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	5,822	6,357	6,530	6,699	7,000	7,255
Operating expenditures	5,554	5,989	6,175	6,333	6,601	6,851
Operating balance	268	368	355	366	399	404
Operating balance (% of operating revenues)	4.6	5.8	5.4	5.5	5.7	5.6
Capital revenues	464	978	633	233	454	554
Capital expenditures	387	795	1,090	1,033	1,113	944
Balance after capital accounts	345	551	(102)	(434)	(260)	14
Balance after capital accounts (% of total revenues)	5.5	7.5	(1.4)	(6.3)	(3.5)	0.2
Debt repaid	100	289	161	250	100	350
Gross borrowings	0	0	0	823	630	1,024
Balance after borrowings	116	(216)	15	0	0	23
Modifiable revenues (% of operating revenues)	87.6	84.4	83.7	84.3	83.2	82.8
Capital expenditures (% of total expenditures)	6.5	11.7	15.0	14.0	14.4	12.1
Direct debt (outstanding at year-end)	700	411	250	823	1,353	2,027
Direct debt (% of operating revenues)	12.0	6.5	3.8	12.3	19.3	27.9
Tax-supported debt (outstanding at year-end)	740	454	290	863	1,393	2,067
Tax-supported debt (% of consolidated operating revenues)	12.7	7.1	4.4	12.4	19.3	27.0
Interest (% of operating revenues)	0.3	0.8	0.6	0.3	0.5	0.8
National GDP per capita (SEK)	431,044	445,182	458,112	473,969	489,957	506,936

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.

Ratings Score Snapshot

Table 2

Municipality of Nacka Ratings Score Snapshot	
Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Strong
Budgetary performance	Strong
Liquidity	Exceptional
Debt burden	Very low
Contingent liabilities	Very 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

- S&P Global Ratings Definitions, Oct. 31, 2018
- Sovereign Risk Indicators, Oct. 11, 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

- 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
- Swedish Local And Regional Government Risk Indicators: April 2017 Update, April 5, 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

Municipality of Nacka

Issuer Credit Rating

AAA/Stable/A-1+

Additional Contact:

EMEA Sovereign and IPF; SovereignIPF@spglobal.com

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

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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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