

Municipality of Nacka

December 6, 2021

This report does not constitute a rating action.

Credit Highlights

Overview

Credit context and assumptions

Strong tax-revenue growth, fueled by the economic recovery, and Nacka's favorable economic profile support its fiscal position.

--The economic recovery in Sweden, alongside the municipality's favorable socioeconomic profile, will boost tax revenue through 2023.

--In combination with tight cost control, Nacka is likely to weather cost pressures from the increasing population.

--Operating margins are set to decrease from the very strong levels in 2020-2021, as the extraordinary government support is phased out and the lowered local tax rate is likely to weigh on revenue growth through 2023.

Base-case expectations

Strong operating performance and large capital revenue help contain debt accumulation from high investment.

-- Nacka's strong operating performance and substantial inflow of capital revenue will reduce its borrowing needs.

--However, we expect the debt burden to gradually increase due to large investment from the growing population and subway network's extension.

--We expect Nacka's liquidity position will remain solid, with a coverage ratio well above 120% of its annual debt service.

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We forecast the Municipality of Nacka's operating performance will weaken some over the coming two years from very strong levels in 2020 and 2021, owing to slower revenue growth from reduced grants and the tax-rate reduction in 2022, alongside our expectation of higher operating spending from a growing population. Nacka needs to invest in local infrastructure to cater to its growing population and the subway network extension in Stockholm, so we believe investment will remain elevated throughout our forecast period. However, we expect the municipality will sell land regularly, which will contain the debt burden's growth somewhat. Furthermore, we expect Nacka will maintain its favorable liquidity position, supported by ample reserves of contracted facilities and strong access to external financing.

Outlook

The stable outlook reflects our expectation that Nacka will balance operating spending pressures and lower revenue growth and uphold sound operating performance. In addition, we anticipate that the municipality's debt, although increasing, will remain contained from regular asset sales related to land holdings owned by the municipality. Furthermore, we expect Nacka to maintain exceptionally strong liquidity, alongside conservative and prudent financial policies.

Downside scenario

We could consider a downgrade if the municipality's debt increased significantly beyond our projections and we expected this situation to become permanent, without 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

Political stability, strong ties to the dynamic Stockholm region, and a strong recovery of the Swedish economy supports Nacka's fiscal position

The political landscape in Nacka is stable, with a right-center majority administration. The political leadership, in tandem with the team of civil servants, has a track record of prudently managing its expenditure and implementing necessary policy reforms, and the quality of its provided services ranks highly from a domestic comparison. We believe the reduced local tax rate in 2022 by 0.25 percentage points (to 17.98%) is manageable because we expect the municipality to have sufficient headroom to its internal surplus target, supported by strong budgetary discipline. In addition, we believe its treasury management demonstrates risk minimizing and very conservative debt and liquidity policies.

Nacka benefits from the Sweden's comparably high wealth levels and strong economic recovery, reflected in our estimate of 2021 national GDP per capita at about \$61,000. The municipality's unemployment has recovered from its peak in mid-2020 of about 6.9%, down to 4.7% in October 2021, which is well below regional and national levels. The local economy remains strong and resilient, owing to its close integration with the Stockholm region and its favorable socioeconomic profile, illustrated, for instance, by its high income levels compared with those of domestic peers. We also expect Nacka's population growth will remain above the national average, supporting strong tax-revenue growth.

We consider the institutional framework generally supportive of Swedish LRGs, but that is weakening. Before the pandemic, the sector's budgetary performance was deteriorating 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 pandemic, illustrated by the extensive amount of extraordinary grants to the sector, supports our opinion.

Tax-revenue growth will remain strong on material population growth, despite the reduced local tax rate

Similar to our forecast a year ago, we expect Nacka will post strong, if gradually weakening, operating results through 2023, compared with those from 2020 and 2021. The performance in those years is boosted by extraordinary support from the Swedish central government. As extraordinary grants will be phased out in 2022, tax-revenue growth to be negatively affected by the tax-rate reduction, and operating spending is set to increase owing to population growth and the reopening of society, we expect operating performance to gradually weaken through 2023. However, we do not expect a material deterioration because we expect the municipality to remain committed to budgetary discipline and address any major pressure to comply with its internal accrual based 2%-surplus target.

We forecast Nacka will post moderate deficits after capital accounts in the next two years, owing to large investment caused by high population growth and demographic changes. The municipality is required to undertake certain investments and prepare for new construction of housing related to the subway network's extension in Stockholm. During the year, Nacka made additional provisions of Swedish krona (SEK) 424 million due to increased costs related to the subway extension, and we understand the related cash

Municipality of Nacka

outflow lie beyond our forecast period. We expect capital revenue will remain high throughout the forecast period, primarily from selling land and real estate. Historically, Nacka has managed to contain its debt burden as asset sales has been higher than expected. We have conservatively forecast asset sales but acknowledge that this could reduce the borrowing needs further, should they materialize at higher amounts.

In addition to the municipality's own investments, Nacka's relatively small company sector, mainly related to its water and waste company (Nacka Vatten och Avfall AB), has relatively large upcoming investments that require debt financing from the municipality's in-house bank. Through 2023, we believe the company sector has borrowing needs of about SEK340 million.

We do not expect Nacka will add any new debt in 2021, owing to strong cash generation in 2020 and 2021. Starting in 2022, we forecast the municipality will add about SEK350 million per year to its tax-supported debt, which apart from its direct debt also includes extended guarantees of about SEK35 million. We believe debt will continue to increase beyond our forecast period. Moreover, owing to the water company's business risk profile and financial position, we consider it a mitigating factor in Nacka's total debt burden. Adjusted for the water company, we estimate the municipality's tax-supported debt would be less than 15% of consolidated revenue.

The 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 the capital markets. Nacka does not have any commercial paper borrowings outstanding, which, combined with a relatively small debt burden, result in limited annual refinancing needs. We expect a pickup in commercial paper borrowings over the coming two years, but not enough to put any pressure on the liquidity cover ratio.

We include SEK2.2 billion of cash, liquid financial assets (including an appropriate haircut), and committed backup, as liquidity sources. We estimate the municipality has upcoming borrowing needs of about SEK360 million, excluding its owned companies, and we expect it will service SEK470 million of maturing debt and interest on average over the coming 12 months.

Municipality of Nacka Selected Indicators

Mil. SEK	2018	2019	2020	2021bc	2022bc	2023bc
Operating revenue	6,540.0	6,857.0	7,257.0	7,483.4	7,661.2	7,889.5
Operating expenditure	6,256.0	6,582.0	6,816.0	6,971.5	7,249.3	7,499.7
Operating balance	284.0	275.0	441.0	511.9	411.9	389.9
Operating balance (% of operating revenue)	4.3	4.0	6.1	6.8	5.4	4.9
Capital revenue	132.0	879.0	845.0	205.2	679.3	412.8
Capital expenditure	935.0	1,153.0	991.0	1,025.5	1,466.3	1,217.8
Balance after capital accounts	(519.0)	1.0	295.0	(308.5)	(375.1)	(415.1)
Balance after capital accounts (% of total revenue)	(7.8)	0.0	3.6	(4.0)	(4.5)	(5.0)
Debt repaid	700.0	900.0	650.0	0.0	500.0	250.0
Gross borrowings	1,350.0	1,400.0	600.0	0.0	990.0	825.0
Balance after borrowings	93.0	(108.0)	275.0	(308.5)	(65.1)	(0.1)
Direct debt (outstanding at year-end)	900.0	1,400.0	1,350.0	1,350.0	1,840.0	2,415.0
Direct debt (% of operating revenue)	13.8	20.4	18.6	18.0	24.0	30.6
Tax-supported debt (outstanding at year-end)	943.0	1,439.0	1,387.0	1,387.0	1,877.0	2,452.0

Municipality of Nacka Selected Indicators

Tax-supported debt (% of consolidated operating revenue)	13.9	20.2	18.4	17.8	23.5	29.9
Interest (% of operating revenue)	0.0	0.1	0.1	0.1	0.1	0.1
Local GDP per capita (\$)	--	--	--	--	--	--
National GDP per capita (\$)	54,885.6	52,186.7	52,390.1	59,263.4	60,080.1	63,545.6

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, Oct. 12, 2021

Related Criteria

- 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

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Nov. 4, 2021
- Extra Funding In Sweden's 2021 Budget Will Support LRGs, Sept. 24, 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
- Comparative Statistics: European Local And Regional Government Risk Indicators, Sept. 1, 2021
- Non-U.S. Local Governments: To What Extent Did Sovereign Support Offset The Pandemic Dwindraft, July 19, 2021
- Local Government Debt 2021: Global Borrowing To Hit \$2.25 Trillion, March 25, 2021
- Swedish Municipalities, Dec. 3, 2019

Ratings Detail (as of December 01, 2021)*

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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