

Research Update:

Sweden's City of Goteborg 'AA+/A-1+' Ratings Affirmed; Outlook Stable

September 11, 2020

Overview

- The unprecedented central government support implemented to address the economic impact of COVID-19 will mitigate the pressure on tax revenue growth and boost the city of Göteborg's operating performance.
- We expect the total investment needs in the municipality and company sector will increase throughout the forecast period, leading to widening deficits after capital accounts and steady debt accumulation.
- We are affirming our 'AA+/A-1+' issuer credit and 'K-1' Nordic regional scale ratings on Göteborg, with a stable outlook.

Rating Action

On Sept. 11, 2020, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on the Swedish city of Göteborg. The outlook is stable. We also affirmed our 'K-1' short-term Nordic regional scale rating on the city.

Outlook

The stable outlook reflects our expectation that Göteborg, despite the challenging parliamentary situation and financial challenges triggered by the COVID-19 pandemic, will maintain its sound financial position and post relatively stable operating results through 2022. We expect management to uphold budgetary discipline and remain committed to its conservative financial policies. Furthermore, despite high investment needs in the coming years caused by the city's growing population, we expect Göteborg's experienced treasury will limit debt accumulation and adhere to its internal policies.

Downside scenario

We could consider lowering the ratings if a negative budgetary trajectory led to deficits after

PRIMARY CREDIT ANALYST

Linus Bladlund
Stockholm
+ 46-8-440-5356
linus.bladlund
@spglobal.com

SECONDARY CONTACT

Erik A Karlsson
Stockholm
+ 46(0)84405924
erik.karlsson
@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF
@spglobal.com

capital accounts structurally above 10% of total revenue or the debt burden expanded beyond our expectations. Furthermore, we could take a negative rating action if medium-term systemic support to the local and regional government (LRG) sector proves insufficient.

Upside scenario

We could raise the ratings if a higher degree of political consensus, with Göteborg maintaining tighter control over expenditure, leads to structurally improved operating margins at above 5% of revenue. In this scenario, we also expect the city's debt burden would decrease owing to stronger cash flow generation.

Rationale

Owing to unprecedented central government support to the LRG sector in light of the COVID-19 outbreak, we expect Göteborg's operating performance to remain relatively stable through 2022. However, similar to other LRGs in Sweden, Göteborg faces demographic challenges, driven partly by an unfavorable old-age dependency ratio. Also, the city's political situation remains difficult owing to the fragmented parliament governed by a minority government. Because of Göteborg's high investment needs in the coming years, we expect debt levels will increase through 2022, although the lion's share will be on-lent to financially strong subsidiaries, in particular the housing company.

The fragmented parliamentary situation remains, while sectorwide risks could pressure credit quality

The political situation remains challenging in Göteborg, because the ruling center-right coalition holds only 30% of local parliament seats. The fragmented parliamentary constellation induced a tumultuous budget process in November, when the opposition voted against the coalition's proposed budget, pointing to exorbitant efficiency measures proposed for the educational department. Although we consider the civil servant team a mitigating factor, we believe the political leadership lacks sufficient support to implement necessary policy reforms to contain the city's spending and debt burden.

In recent years, higher expenditure, accentuated by central government policymaking and insufficient compensation mechanisms, and countermeasures undertaken by the LRGs have led to weaker performance in the sector. As a result, we see the institutional framework for Swedish LRGs as weakening. Nevertheless, we consider Sweden's institutional framework for LRGs extremely predictable and supportive, owing to its high degree of institutional stability, far-reaching equalization system, and local tax autonomy.

Göteborg continues to benefit from Sweden's strong economic position, demonstrated by our national GDP per capita forecast of about \$51,100 in 2020. Göteborg is Sweden's second-largest city and, as an industrial and regional center, a hub for international trade. Its employment structure and socioeconomic profile are roughly on par with national levels.

Government support will mitigate pressure on operating performance but debt continues to increase, driven by high investment needs

Despite the adverse economic effects from COVID-19 and structural demographic challenges, we

expect Göteborg to post relatively stable operating margins through 2022. Since the pandemic's onset, the central government has announced unprecedented support packages to the LRG sector, especially for 2020. On Sept. 7, the ruling coalition presented additional general grants of Swedish krona (SEK) 10 billion for 2021 and SEK5 billion for 2022. In addition, the Prime Minister pledged considerable support for elderly care around the country. The central government has also provided extensive support to the private sector, partly through employment support schemes whereby a share of heavily affected companies' personnel expenditure is paid by the central government. Together with the comprehensive unemployment benefit system built in to the Swedish welfare system, these measures have limited the negative effects on tax revenue growth for 2020. Furthermore, we expect Göteborg to continue implementing efficiency measures across the municipal departments, although the fragmented parliamentary situation could impede political action. Toward the end of the forecast period, we expect operating performance to improve somewhat compared with 2021 as tax revenue growth starts to pick up.

In our view, the relatively large dividends Göteborg extracts from its company sector are unsustainable, as they impair the government-related entities' (GREs') financial flexibility. Instead of implementing policy reforms, the city uses these dividends to partly cover increasing operating spending. Given the political situation, we do not foresee any major reduction of the dividends, and we forecast the city will extract about SEK540 million per year through 2022.

We forecast Göteborg's deficits after capital accounts will increase throughout the forecast period, driven by high investment needs in both the municipality and the company sector. Over the past year, the capacity within the construction sector has improved; in combination with refined internal processes, this has resulted in higher completion rates and investment volumes. In particular, we expect these improvements will affect the investment levels of the housing company, Förvaltnings AB Framtiden (AA-/Stable/A-1+), which is the main driver of debt accumulation in the company sector. Consequently, we forecast a gradual increase in the city's debt burden over the coming years.

Göteborg's debt and liquidity management is centralized via the in-house bank, which is responsible for the city's and GREs' funding needs. We consider it a mitigating factor that Göteborg has on-lent a significant share of its debt to companies that, in our view, have strong and stable business risk profiles. These companies include Framtiden and Gryaab, the water and waste company. Furthermore, we regard the city's contingent liabilities, including its joint and several guarantee extended to Kommuninvest, as limited.

Göteborg's very favorable liquidity position relies on an ample mix of contracted facilities and liquid assets, including a 'AAA' rated covered bonds portfolio as well as facilities with the European Investment Bank and Council of Europe Development Bank. We expect debt repayments will be stable throughout the forecast period, although high investments will weigh negatively on the liquidity ratio, if marginally. In addition, we believe Göteborg's experienced treasury department would take action and secure additional liquidity sources if needed to maintain the coverage ratio. We estimate the weighted debt service coverage ratio at 152%. Furthermore, in line with other Swedish LRG peers, Göteborg has a strong track record of reliable access to external financing.

Key Statistics

Table 1

City of Goteborg--Selected Indicators

(Mil. SEK)	--Fiscal year ended Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenues	40,561	42,050	43,550	45,600	46,246	47,444
Operating expenditures	38,522	40,177	41,699	43,120	44,389	45,420
Operating balance	2,039	1,873	1,851	2,480	1,857	2,024
Operating balance (% of operating revenues)	5.0	4.5	4.3	5.4	4.0	4.3
Capital revenues	824	2,163	1,652	1,336	1,170	1,470
Capital expenditures	3,600	4,950	5,682	5,045	5,747	6,637
Balance after capital accounts	(737)	(914)	(2,179)	(1,229)	(2,720)	(3,143)
Balance after capital accounts (% of total revenues)	(1.8)	(2.1)	(4.8)	(2.6)	(5.7)	(6.4)
Debt repaid	5,832	5,939	9,872	10,055	10,172	11,950
Gross borrowings	10,602	6,916	12,965	14,566	17,152	18,006
Balance after borrowings	155	(257)	(446)	448	0	0
Direct debt (outstanding at year-end)	37,336	38,313	41,879	46,391	53,521	59,650
Direct debt (% of operating revenues)	92.0	91.1	96.2	101.7	115.7	125.7
Tax-supported debt (outstanding at year-end)	39,834	41,414	45,819	50,528	57,865	64,211
Tax-supported debt (% of consolidated operating revenues)	69.8	71.1	75.5	80.1	90.3	97.8
Interest (% of operating revenues)	1.2	1.1	1.2	1.1	1.3	1.4
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	462,734	477,094	490,783	467,584	491,779	511,257

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. N/A--Not applicable. SEK--Swedish krona.

Ratings Score Snapshot

Table 2

City of Goteborg--Ratings Score Snapshot

Key rating factors	Score
Institutional framework	1
Economy	1
Financial management	3
Budgetary performance	3
Liquidity	1
Debt burden	3

Table 2

City of Goteborg--Ratings Score Snapshot (cont.)

Key rating factors	Score
Stand-alone credit profile	aa+
Issuer credit rating	AA+

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, July 14, 2020. Interactive version available at <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

- 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
- Forvaltnings AB Framtiden, Oct. 25, 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 Study And Rating Transition Study, Aug. 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 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

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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

Ratings Affirmed

Goteborg (City of)

Issuer Credit Rating	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AA+
Commercial Paper	
Global Scale	A-1+
Nordic Scale	K-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.

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