

Research Update:

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

March 10, 2023

Overview

- We believe the City of Göteborg's governing minority coalition, following the September 2022 election, will help create a more stable political landscape than the fragmented politics of the 2018-2022 term.
- Göteborg will likely sustain budgetary resilience through 2025, albeit weaker than in 2020-2022 because of expected weaker macroeconomic fundamentals and inflationary pressure ahead.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Göteborg. The outlook is stable.

Rating Action

On March 10, 2023, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the Swedish city of Göteborg. The outlook is stable.

At the same time, we affirmed our 'K-1' Nordic regional scale rating.

Outlook

The stable outlook reflects our expectation that Göteborg, on the back of a less fragmented political landscape, will maintain a sound financial position and post relatively steady operating results through 2025, despite weaker macroeconomic fundamentals and inflationary pressure. We expect management will uphold budgetary discipline and remain committed to its conservative financial policies.

Downside scenario

We could consider lowering the ratings if management fails to address a negative budgetary trajectory that led to deficits after capital accounts structurally above 10% of total revenue.

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Upside scenario

We could raise the ratings if Göteborg tightens control over expenditure, translating into operating balances above 5% on a structural basis. Ratings upside would also hinge on a considerable reduction in debt, potentially on the back of divestments in the company sector.

Rationale

We expect Göteborg's operating performance, thanks to a more stable political landscape, will remain resilient through 2025, albeit somewhat weaker than the inflated results in 2020-2022. Expenditure pressure from inflation, higher pensions costs, and demographic challenges will be counterbalanced by solid tax revenue growth. At the same time, we believe Göteborg will remain committed to budgetary discipline and implement necessary efficiency measures to meet internal surplus targets and uphold a sound financial position. Because of Göteborg's high investment needs in the coming years, we expect debt will increase gradually through 2025. That said, a significant share of new debt will be on-lent to financially strong subsidiaries, notably the housing company.

The lack of majority rule in the local parliament is unlikely to create more waves than the previously fragmented political situation

The September 2022 election yielded a new minority coalition consisting of the Social Democrats, the Left Party, and the Green Party; together, they hold 40 out of the 81 seats in the local parliament. Despite the lack of majority rule, we believe the political landscape is notably more stable than the fragmented political situation in the previous term, 2018-2022, when a weak, right-leaning coalition governed the city. That coalition was unable to proceed with all its priorities, resulting in give-and-take politics. At this time, we think the risks of a similar dynamic have diminished, considering the new coalition and a technical agreement with the Centre Party. We also think the city will not extract unsustainable dividends that would strain the company sector financially. Furthermore, we consider the civil servant team to be highly experienced, especially that in charge of the treasury department.

We regard the institutional framework in Sweden as extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the sector's revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. Moreover, the central government's swift response to the COVID-19 pandemic, partly through the distribution of general grants to the local and regional government (LRG) sector, supports our view.

Since the pandemic, the central government has remained supportive of LRGs, implementing both direct and indirect support packages to boost operating performance for Swedish municipalities. Although structural challenges remain and budgetary performance could weaken somewhat as extraordinary support is phased out, we see limited risk of a material deterioration of the sector's financial stability.

Göteborg benefits from Sweden's strong economic position, demonstrated by our national GDP per capita forecast of about \$58,950 in 2023. 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.

Continued central government support, robust tax revenue, and budgetary discipline should mitigate pressure on Göteborg's performance metrics

We assume Göteborg's strong 2022 operating performance enables the city to manage inflationary pressure and higher pension costs over the coming few years. Last year, we continuously revised upward our budgetary performance projections due to strengthening tax revenue. At the same time, operating expenditure rose slower than anticipated in some budgetary units. This strong budgetary performance prompted Göteborg to cancel the planned dividend of Swedish krona (SEK) 220 million from the company sector.

Through 2025, we expect Göteborg's operating balances will slip below 5% because of weaker macroeconomic fundamentals, inflationary pressure, and structural demographic issues. Moreover, pension costs will increase in 2023-2024 because of a new agreement for public employees and expectations of higher inflation. On an accrual basis, the increase in pension costs will have a notable impact on Swedish LRGs' income statements, but a share of these expenditures will not give rise to a cash outflow. Göteborg budgeted a deficit in the income statement, in part, because of the higher pension expenditure in 2023. However, the city will use some of its accumulated equity reserves to meet the balanced budget requirement if necessary. We expect management will remain committed to budgetary discipline and its surplus targets, underpinning the city's sound financial position.

We forecast that high investment needs, in both the municipality and the companies, will keep Göteborg's deficits after capital accounts between 4% and 6% of total revenue over 2023-2025. This will be somewhat offset by asset sales and land development gains in the coming years. In the company sector, we expect the borrowing needs of housing company Förvaltnings AB Framtiden (AA-/Stable/A-1+), which is the main spur of debt accumulation in the company sector, will remain notable through 2025. At the same time, the energy company, Göteborg Energi AB, has increased its borrowing needs, partly due to investments related to sustainability targets. As such, we expect the city's debt accumulation will near a noteworthy 130% of operating revenue by 2025.

Göteborg's debt and liquidity management is centralized via the in-house bank, which is responsible for the city's and the companies' funding needs. That Göteborg has on-lent a significant share of its debt to companies with, in our view, strong and stable business risk profiles mitigates any potential risks from this centralization. These companies are the housing company Framtiden and the water and waste company Gryaab. If we adjust for the onlending to these companies, the debt ratio falls to 74%. Furthermore, we regard the city's contingent liabilities, including its joint and several guarantee extended to Kommuninvest, as limited.

We assume the Swedish central bank, the Riksbank, will continue to raise the policy rate to combat inflation. As a result, we expect a substantial uptick in the city's interest expenses, reaching 4.0% of operating revenue in 2025. That said, given that Göteborg has on-lent a significant portion of its debt to the company sector, a part of these expenses will be channeled through to the municipal companies and reflected in higher financial revenue, easing the impact on the city's budgetary performance.

Göteborg's liquidity position remains strong; we estimate the weighted debt service coverage ratio at 118%. The city recently contracted additional facilities and extended existing contracts, resulting in a total increase in available liquidity sources. We assume this stemmed from the city's expanding debt burden and the maturity of the 'AAA' rated covered bonds portfolio. That said, as a result of higher debt maturities in 2024-2025, we expect a gradual deterioration of the coverage ratio throughout the forecast period. However, we believe Göteborg stands out positively among Swedish LRGs when it comes to access to external liquidity. As one of the largest municipal

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issuers in the Nordics, the city has been active on the capital markets for decades and has developed a strong name recognition among investors. At the same time, Göteborg has access to a broad range of funding currencies and channels, including bonds, commercial paper, Kommuninvest, the European Investment Bank, the Nordic Investment Bank, and the Council of Europe Development Bank.

Key Statistics

Table 1

City of Goteborg--Selected Indicators

Mil. SEK	--Fiscal year ends Dec. 31--					
	2020	2021	2022e	2023bc	2024bc	2025bc
Operating revenues	43,821	45,233	47,719	49,286	51,302	53,588
Operating expenditures	40,306	42,266	44,415	47,429	49,298	51,399
Operating balance	3,515	2,967	3,304	1,857	2,003	2,189
Operating balance (% of operating revenues)	8.0	6.6	6.9	3.8	3.9	4.1
Capital revenues	1,254	2,479	2,010	1,234	1,324	1,014
Capital expenditures	6,010	5,119	5,116	5,270	6,249	6,502
Balance after capital accounts	(1,241)	327	198	(2,179)	(2,921)	(3,299)
Balance after capital accounts (% of total revenues)	(2.8)	0.7	0.4	(4.3)	(5.6)	(6.0)
Debt repaid	10,055	10,222	11,400	10,248	11,414	12,632
Gross borrowings	13,208	11,704	12,525	16,606	18,769	20,795
Balance after borrowings	639	(263)	453	(381)	0	0
Direct debt (outstanding at year-end)	45,032	46,514	47,639	53,996	61,351	69,514
Direct debt (% of operating revenues)	102.8	102.8	99.8	109.6	119.6	129.7
Tax-supported debt (outstanding at year-end)	50,805	52,425	52,918	59,381	66,843	75,116
Tax-supported debt (% of consolidated operating revenues)	82.2	82.4	79.3	86.5	94.1	101.9
Interest (% of operating revenues)	1.0	0.8	1.1	2.1	2.6	4.0
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	487,872	525,259	579,467	616,013	638,898	660,097

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.

Ratings Score Snapshot

Table 2

City of Goteborg--Ratings Score Snapshot

Key rating factors

Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	3
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, Dec. 12, 2022. An interactive version is available at <http://www.spratings.com/sri>.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Forvaltnings AB Framtiden 'AA-/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable, Oct. 26, 2022
- Institutional Framework Assessment: Swedish Municipalities And Counties, Dec. 13, 2021
- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022
- Most Rated Swedish LRGs Can Absorb Higher Interest Costs, Sept. 12, 2022
- Southern Swedish LRGs Bear The Brunt Of Surging Electricity Prices, July 20, 2022
- Swedish Local Governments Are Holding Up Against Cyber Attacks, Jan. 26, 2022

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

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

Ratings Affirmed

Goteborg (City of)

Issuer Credit Rating	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AA+
Commercial Paper	A-1+
Commercial Paper	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. 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 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; or Stockholm (46) 8-440-5914

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