

Research Update:

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

March 13, 2020

Overview

- The challenging budget process highlights the difficulties Göteborg's administration faces in implementing necessary policy reforms, resulting from the fragmented parliamentary situation.
- Despite this, we forecast that additional central government grants and improved revenue growth toward year-end 2022 will support stable, albeit weaker, operating results.
- We are affirming our 'AA+/A-1+' issuer credit and 'K-1' Nordic regional scale ratings on Göteborg and maintaining the stable outlook.

Rating Action

On March 13, 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, will maintain its sound financial position through 2022. We expect management to uphold budgetary discipline and conservative debt policies, notwithstanding increasing operating spending and high investments caused by the city's expanding population.

Downside scenario

We could consider lowering the ratings if the challenging political situation hampers necessary policy reforms to contain spending, or should sufficient systemic support remain absent. We would expect to observe deficits after capital accounts structurally above 10% of total revenue or an expanding debt burden, if this scenario materialized.

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Upside scenario

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

Rationale

We believe the challenging budget process last year indicates an inability to implement necessary policy reforms in the city, given that Göteborg's political situation remains difficult owing to the fragmented parliament and minority government. However, we still consider the city's civil servants a mitigating factor, and we anticipate financial performance will remain stable on the back of the supportive local economy and Swedish institutional framework. We have, however, observed increasing sectorwide risks related to the deteriorating performance of Sweden's local and regional governments (LRGs). Because of Göteborg's high investments, we expect debt levels to increase notably over the coming two years, although the lion's share is to be lent on to financially strong subsidiaries, which mitigates some risk.

Political uncertainty and increasing sectorwide risks could weigh negatively on the city's credit quality

During the budget process in November last year, the opposition halted proposed efficiency measures within the educational department. The political situation remains fragmented in Göteborg, because the incumbent minority government holds only about 30% of local parliament seats. Although we regard the strong team of civil servants as a mitigating factor, and the effect on the budget from the halt of the efficiency measures was not material, we believe the political leadership is increasingly unable to make necessary policy decisions to contain the city's spending and debt burden. In particular, we consider the situation to have deteriorated since our last review in September 2019.

Greater expenditure, accentuated by central government policymaking and insufficient compensation mechanisms and LRG countermeasures, has led to LRGs' weaker performance. As a result, we see a gradually weakening trend for the institutional framework for Swedish LRGs. Nevertheless, we still consider Sweden's institutional framework for LRGs as extremely predictable and supportive, thanks to its high degree of institutional stability, far-reaching equalization system, and local tax autonomy.

Moreover, Göteborg benefits from Sweden's strong economic position, reflected by our estimate of national GDP per capita of about Swedish krona (SEK) 500,600 (about \$53,300) in 2020. Göteborg is Sweden's second-largest city and, as an industrial and regional center, a natural hub for international trade. Its employment structure and socioeconomic profile are roughly at par with national levels.

Large spending needs pressure the city's operating performance, and are pushing debt upward

We expect a gradual deterioration of the city's operating performance over the coming two years. In addition to demographic pressure, the most recent revision of the equalization system will adversely affect Göteborg once fully implemented in 2022, because the city's contributions to the

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system will increase. However, the effect is negligible in 2020 given that the city receives an implementation grant that compensates for the effect, in addition to a temporary grant. In the coming years, as these grants are phased out, we expect pressure on margins. Moreover, we forecast some improvement in tax revenue growth as the Swedish economy improves relative to 2020-2021. However, we acknowledge that a sustained COVID-19 pandemic and market unrest could lead to an economic downturn and adversely affect Göteborg's tax-revenue growth toward the end of the forecast period.

The relatively large dividends Göteborg extracts from its company sector are unsustainable, in our view, as they deplete its government-related entities' (GREs') financial flexibility. Instead of policy reforms, the city balances its increasing operating spending with these dividends. Given the political situation, we do not foresee any major reduction of the dividends, and we forecast the city will extract about SEK500 million per year through 2022.

We forecast Göteborg's deficits after capital accounts will increase notably over previous years, owing mainly to improved completion rates on investments and weaker operating performance. The city's investments are mainly in core municipal infrastructure. Over the past year, the capacity within the construction sector has improved, which, in combination with improved internal processes, will cater for higher capital expenditure. In our view, this will also spur increased investments among GREs, especially housing company Förvaltnings AB Framtiden (Framtiden; AA-/Stable/A-1+). We therefore expect a notable spike in the city's direct debt levels over the coming two years.

Göteborg's debt and liquidity management is centralized via the in-house bank that caters for the city's funding needs and those of its GREs. We consider it a mitigating factor that the city has lent on about half its debt to companies that we consider financially strong, and that have commercial business profiles. These companies are Framtiden, Göteborg Energi AB (energy), Göteborgs Hamn AB (harbor), and Gryaab (water and waste). Furthermore, we regard Göteborg'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 liquidity facilities and liquid assets that covers 152% of the next 12 months' debt service, as well as our view of strong access to external liquidity.

In our calculation, we include SEK14.6 billion of contracted backups, overdrafts, and facilities with the European Investment Bank and the Council of Europe Development Bank. We also include SEK3.4 billion of cash and liquid assets invested in covered bonds. Furthermore, we estimate Göteborg has SEK1.7 billion in upcoming funding needs. We calculate that the city will service SEK10.7 billion of debt and interest in the next 12 months, including guaranteed loans held directly by its GREs.

Key Statistics

Table 1

City of Goteborg Selected Indicators

(MIL. SEK)	--Fiscal year ending Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenues	40,561	42,050	43,550	45,575	46,410	47,751
Operating expenditures	38,522	40,177	41,699	43,416	44,754	46,106
Operating balance	2,039	1,873	1,851	2,159	1,656	1,645

Table 1

City of Goteborg Selected Indicators (cont.)

(Mil. SEK)	--Fiscal year ending Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating balance (% of operating revenues)	5.0	4.5	4.3	4.7	3.6	3.4
Capital revenues	824	2,163	1,652	1,691	1,370	1,670
Capital expenditures	3,600	4,950	5,682	5,822	6,158	6,637
Balance after capital accounts	(737)	(914)	(2,179)	(1,971)	(3,131)	(3,322)
Balance after capital accounts (% of total revenues)	(1.8)	(2.1)	(4.8)	(4.2)	(6.6)	(6.7)
Debt repaid	5,832	5,939	9,872	10,167	10,172	11,950
Gross borrowings	10,602	6,916	12,965	15,531	16,857	18,543
Balance after borrowings	155	(257)	(446)	448	0	0
Direct debt (outstanding at year-end)	37,336	38,313	41,879	47,243	53,928	60,521
Direct debt (% of operating revenues)	92.0	91.1	96.2	103.7	116.2	126.7
Tax-supported debt (outstanding at year-end)	39,834	41,414	45,819	51,380	58,272	65,082
Tax-supported debt (% of consolidated operating revenues)	69.8	71.1	75.5	81.5	90.7	98.7
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)	462,329	477,636	490,591	500,646	512,881	526,971

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

City of Goteborg Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	3
Budgetary performance	3
Liquidity	1
Debt burden	3
Stand-alone credit profile	aa+

Table 2

City of Goteborg Ratings Score Snapshot (cont.)

Key rating factors	Scores
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

- Research Update: Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable, Feb. 14, 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

- Swedish Government To Mitigate Impact From Coronavirus On Local And Regional Governments, March 11, 2020
- Sovereign Risk Indicators, Dec. 12, 2019. Interactive version available at <http://www.spratings.com/sri>
- 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
- Sweden's Municipal Sector Faces An Equalization Shake-Up, Sept. 13, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 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
- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 22, 2019
- European Local And Regional Government Risk Indicators, Nov. 9, 2018

In accordance with our relevant policies and procedures, the Rating Committee was composed of

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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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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