

CREDIT OPINION

8 May 2017

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RATINGS

Gothenburg, City of

Domicile	Sweden
Long Term Rating	Aaa
Type	Senior Unsecured - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Gothenburg, City of Annual Update

Summary Rating Rationale

The Aaa long-term debt rating with stable outlook and P-1 short-term rating of the City of Gothenburg reflects the city's robust financial position underpinned by a track record of positive gross operating balances, a supportive institutional framework, Gothenburg's role as an industrial hub and its current low net debt levels. The rating also takes into account our expectation that the city will borrow more in coming years in order to finance investments required to provide services and infrastructure to a growing and aging population.

Credit Strengths

- » Robust financial performance with positive gross operating balances
- » Strong institutional framework with established equalisation system
- » Gothenburg's economic strength as an industrial and transport hub
- » Currently low level of net debt, although expected to increase

Credit Challenges

- » Growing population to put pressure on required investment and debt levels
- » Refinancing risk due to debt structure and reliance on short term borrowing
- » Large city-owned company sector forecasted to increase although control has been enhanced through modified corporate governance guidelines

Rating Outlook

The outlook is stable.

Factors that Could Lead to a Downgrade

- » A loosening of the prudent budget discipline, resulting in a significant increase in expenditure and operating deficits
- » A significant increase in investment levels and consequently debt burden and/or city owned companies seizing to contribute dividends to the city
- » A weakening of the importance of local government and consensus with the central government regarding the delivery of public services
- » A downgrade of the sovereign, the [Government of Sweden](#) (Aaa stable)

Key Indicators

Exhibit 1

Gothenburg, City of

	2012	2013	2014	2015	2016
Net direct and indirect debt / operating revenue (%)	10.7%	12.2%	9.0%	10.5%	11.1%
Gross interest expenses / operating revenue (%)	4.6%	3.6%	2.9%	1.6%	1.4%
Gross operating balance / operating revenue (%)	4.0%	4.0%	3.9%	3.7%	4.4%
Cash financing surplus (requirement) / total revenue (%)	5.2%	22.0%	-1.5%	-5.1%	-2.5%
Intergovernmental revenues / total revenue (%)	5.1%	5.1%	5.5%	6.9%	9.0%

Source: Moody's, City of Gothenburg

Detailed Rating Considerations

Gothenburg's rating combines (1) a baseline credit assessment (BCA) for the city of aa1 and (2) a very high likelihood of extraordinary support coming from the [Government of Sweden](#) (Aaa stable) in the event that Gothenburg faced acute liquidity stress.

Baseline Credit Assessment

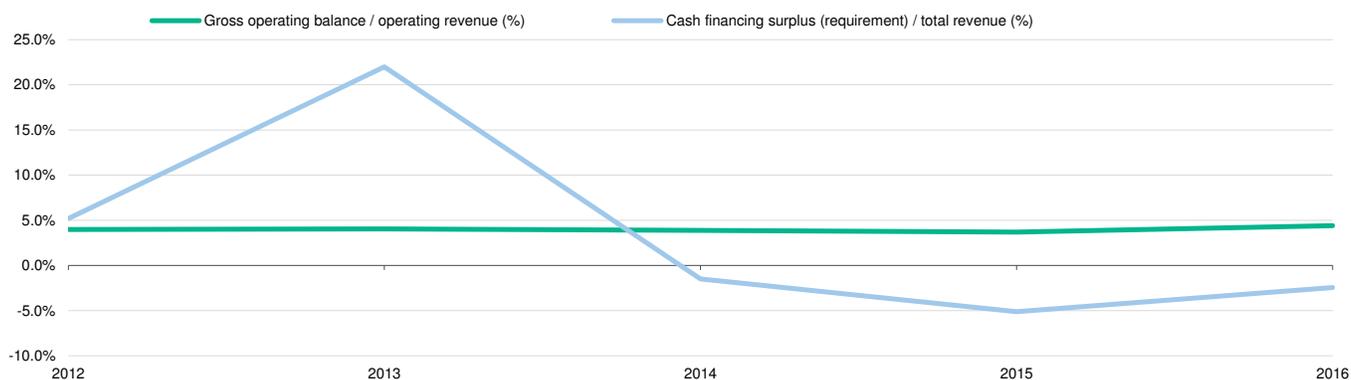
ROBUST FINANCIAL PERFORMANCE WITH POSITIVE GROSS OPERATING BALANCES

The City of Gothenburg has a robust track record of financial performance. The gross operating balance (GOB) has consistently been positive, averaging 4.0% of operating revenues over the last five years and was relatively stable over this period (see Exhibit 2). As a result of increasing population and the need for public services, this ratio is expected to slightly weaken over the next five years. Budget forecasts suggest that in 2017, Gothenburg will reach a balanced budget (excluding dividend income), although we expect the city to outperform their budget and deliver a small operating surplus.

Exhibit 2

Despite stable and positive gross operating balance, the city has been running cash financing deficits to support a growing population

Gross operating balance as a % of operating revenue, cash financing surplus as a % of total revenue, by year



Source: Moody's, City of Gothenburg

In 2016, operating revenues were SEK39.3 billion, a significant increase of 8.8% from 2015 largely driven by additional central government transfers to cover refugee related cost but also thanks to increased tax revenues. The bulk of Gothenburg's revenues stems from local taxes, which accounted for 74% of operating revenues in 2016. Intergovernmental transfers, in the form of tax equalisation grants make up 10%, while other central government (general) grants (e.g. to cover refugee related costs) make up 9% of operating revenues. The remainder of revenues stem from fees and commissions and financial income from city-owned companies. Over the last few years, the breakdown of operating revenue has remained largely unchanged but with a slight shift towards central government transfers in 2016.

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In 2016, operating expenses were SEK37.5 billion, an increase of 8.0% from 2015. More than half of operating expenses consist of personnel costs, which are increasing due to rising demand for public services. The remainder includes: costs of goods and services (32%); interest expenses (1.4%); and transfers for financial assistance (3%).

STRONG INSTITUTIONAL FRAMEWORK WITH ESTABLISHED EQUALISATION SYSTEM

Local governments have unlimited power of taxation and are deemed to have strong revenue and expenditure flexibility. Due to their constitutional position, local governments cannot be declared bankrupt and are fully liable for all obligations they enter into. Since 2000, the requirements for a Balanced Budget have been applied, and any resulting deficits must be corrected within three years. Ultimately, the Swedish state is responsible for ensuring equality in the provision of public services in the country; it therefore closely monitors the municipal sector and annual budgets. The annual balanced budget analysis has concluded that Gothenburg has fulfilled this requirement in 2016 with net earnings of SEK502 million (excluding capital gains), of which more than one third have been transferred to the earnings equalisation reserve.

As is the case for most municipalities in Sweden, Gothenburg receives a grant under the Swedish equalisation system. In 2016, equalisation grants were SEK3.85 billion, a 13% increase from the year before. Other general grants were SEK3.6 billion in 2016, a 41% increase from the previous year (SEK2.5 billion), and again includes additional state grant in support of the rising public expenditure associated with the high number of refugees. Prior to 2015, grants remained relatively stable over several years, but increased significantly since then. These raised government grant levels provide assistance towards the financial costs of the services associated with the integration of immigrants (including asylum seekers). It must be noted however that after 2020, these raised grant levels will revert back to pre-refugee inflow levels and municipalities are expected to allocate internal funding to support the continued integration of refugees.

Sweden's measures to reduce the flow of refugees and the introduction of border controls at the beginning of 2016 contributed to a dramatic decrease in immigration by asylum seekers. Migration by asylum seekers to Sweden is now lower than it has been for five years. Gothenburg received 3,300 new arrivals, which equated to 4.7% of all new asylum seekers in the country. In addition, Gothenburg's own population growth was very high in 2016. Gothenburg has had rapid population growth for several years, and since 2008 it has grown by 7,000 people a year on average. The large increases are due both to high birth rates and to migration into the city. In this respect, the issue of housing availability and provision of public services is very important.

Gothenburg's robust financial performance is supported by a mature and highly developed institutional framework. The division of powers between national, county and municipal governments is clearly defined under acts of the Riksdag. Changes have at times been significant, with responsibilities shifted within levels of government after a process of extensive and meaningful consultation between all levels of government and the Swedish Association of Local Authorities and Regions (SALAR). The local government financing principle is enshrined within government policy so that responsibilities may not be shifted without provision of appropriate resources. Local governments have a critical role in carrying out almost 40% of public primary expenditures and account for approximately 20% of GDP.

GOTHENBURG'S ECONOMIC STRENGTH AS AN INDUSTRIAL AND TRANSPORT HUB

Gothenburg is considered the transport hub of Scandinavia, Sweden's major industrial centre and home to some of Sweden's largest employers, including companies like [Volvo](#) (Ba2 stable), [Stena](#) (B1 stable) and [SKF](#) (Baa2 stable). The associated workforce significantly contributes to the city's operating revenues by way of income taxes which are currently set at 21.12% for the City and 11.48% for the county (Västra Götaland). Given that three-quarters of the city's revenues come from local taxes (personal income tax), the strength of the regional economy supports the city's finances. The city's unemployment rate stood at 7.8% in 2016 and has been declining for the last five years despite being marginally higher than the national average (7.6%).

Gothenburg is the second largest city in Sweden with a population of around 556,600 inhabitants, approximately 5.5% of the national total. Gothenburg has seen a steady increase in its population and this trend is expected to continue over the next decade. This growth will increase demand for public services, requiring further investments, which we expect to be partially debt financed. The current low levels of debt could allow Gothenburg to withstand higher levels without a material impact on credit worthiness.

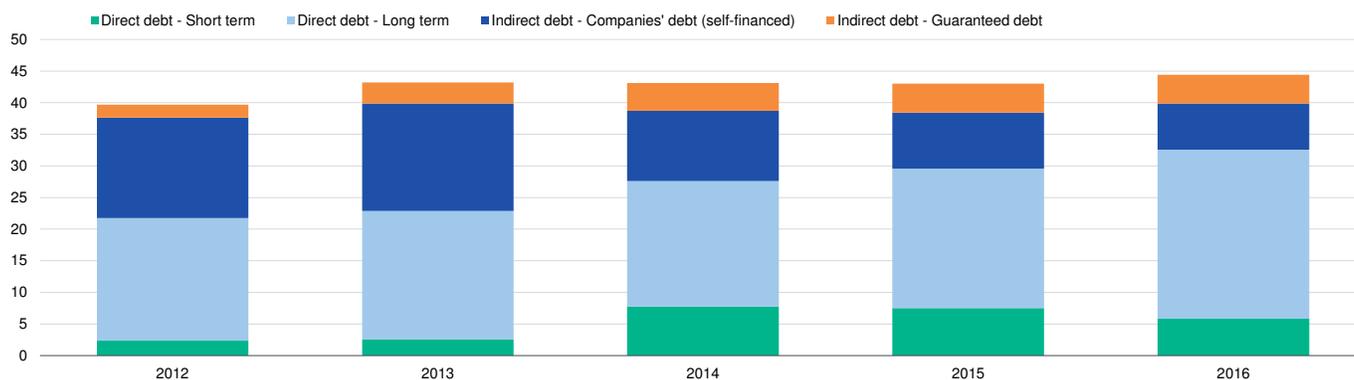
CURRENTLY LOW LEVELS OF NET DEBT, ALTHOUGH EXPECTED TO INCREASE

Net direct and indirect debt are calculated at 11.1% (SEK4.4 billion) of operating revenues (SEK39.3 billion) at year end 2016, slightly above the 10.5% (SEK3.8 billion) recorded in the previous year. Gothenburg currently has low net debt levels because while the city borrows on behalf of city-owned companies, we perceive company on-lending as self-supporting debt. We consider any debt as self-supporting as long as the debt taken on behalf of city-owned companies can be serviced by those companies. As a result, this debt is currently judged as self-supporting due to the companies' strong track record of positive contributions after tax and interest payments. The overall net income of Gothenburg's companies was SEK1.3 billion in 2016, and for 2017, a net income of slightly above SEK1 billion is expected. This would allow for a planned dividend payout to the city of SEK770 million.

Exhibit 3

The City's debt portfolio has been expanding to finance new investments in public services

Direct and Indirect Debt in SEK billion, by year



Source: Moody's, City of Gothenburg

Gothenburg's Aaa rating relies on this self-supporting assumption. When including all obligations, including on-lent self-supporting debt and guaranteed debt, total direct and indirect debt would reach SEK44.4 billion (see Exhibit 3), equivalent to 113% of operating revenues in 2016 (2015: 119%). The largest self-supporting, city-owned borrowers are Förvaltnings AB Framtiden (SEK15.7 billion), Göteborg Energi AB (SEK4.7 billion), and HIGAB (SEK3.5 billion).

We expect that Gothenburg will assume more debt in the coming years in order to support raised investment levels as they aim to provide the necessary services for their growing population. Higher debt levels related to raised investment levels could lead to higher interest costs for the city owned companies and this could compromise Gothenburg's Aaa rating if the companies do not maintain their strong financial performance and net positive contributions. We will closely monitor the companies' net financial positions moving forward.

Gothenburg's funding comes primarily through an EMTN programme, certificate programmes and an ECP programme, together with credit lines from several Nordic large financial institutions. Additional loans include those from the [European Investment Bank](#) (Aaa stable) and [Kommuninvest i Sverige](#) (Aaa stable), a funding vehicle for the local government sector in Sweden.

In addition, Gothenburg was the first city to issue a green bond and has issued four green bonds since 2013 raising a total of SEK4.4 billion. The city's [Green Bond Assessment of GB1](#) (the highest possible grade) reflects its adoption a formal rigorous process to identify, consider, evaluate and select eligible projects for funding through the issuance of green bonds. The fourth bond, issued in June 2016, amounted to SEK1 billion and is due to be repaid in 2022. Proceeds have been allocated to various green initiatives, including sustainable transportation, housing, and energy efficiency. These issuances were able to attract a wider range of investors to the city's investor base and the city plans to tap the green bond market again in the second quarter of 2017.

GROWING POPULATION TO PUT PRESSURE ON REQUIRED INVESTMENT AND DEBT LEVELS

The city has grown by over 10% in the last decade to about 556,600 inhabitants at the end of 2016 primarily through migration and aging. This population growth is exerting pressure on sectors such as housing, education, health care and transportation. To address these pressures, Gothenburg is involved in large projects including the West Swedish Agreement and other infrastructure investments.

The West Swedish Agreement is anticipated to cost SEK34 billion and will be co-financed between the state, regions (Västra Götaland and Region Halland) and Gothenburg City along with income from congestion tax in Gothenburg. To enable the local development plans, the city will need to invest in infrastructure and public service (schools, kindergartens etc.).

The city expects its capital investments to reach around SEK3.5 billion in 2017 compared to SEK2.5 billion in 2016. In addition, the city companies are planning to invest around SEK6 billion in 2017 (compared to SEK5.1 billion in 2016). We expect these investments to be largely financed via increased debt levels. We will continue to monitor the municipal and city company investments and debt levels. We expect this to continue being managed appropriately moving forward.

REFINANCING RISK AND RELIANCE ON SHORT TERM BORROWING

SEK5.8 billion of the Municipality's loans will mature in 2017, equivalent to 18% of total direct debt (SEK32.6 billion). We consider this to be a moderate level of debt maturing in any single year, but the debt structure still exposes the city to some market risk. While this has allowed the city to benefit from the low and even negative interest rate environment, the city has taken steps to lock in low interest rates when refinancing at longer maturities. In December 2016, the average duration of their long term debt maturing was 4.29 years, a positive increase from 3.2 years in December 2015. Internal policy limits refinancing risk by requiring that no more than 35% of total external debt and 25% of long term external debt can mature within 12 months. The existing debt maturity profile falls in line with internal guidelines, recommending that the average maturity of long-term loans should fall between two and six years. Despite this positive trend towards longer debt tenure, we still consider Gothenburg's existing debt structure as relatively short dated compared to other European municipal borrowers.

Mitigating the refinancing risk is a strong liquidity position and policy requirement that the city should hold committed secured facilities that will cover at least 12 month of debt coming due. Despite being short on cash (SEK850 million as of year end 2016), the city holds committed bank facilities amounting to SEK9 billion as of year end 2016 which are available with immediate drawdown. However, the city views this as overly prudent and aims to adjust the drawdown notice period to actual maturities throughout the 12 months period. We deem that the city's coverage policy adequately balances the refinancing risk related to the relatively short dated debt issued by the city.

LARGE CITY-OWNED COMPANY SECTOR FORECASTED TO INCREASE ALTHOUGH CONTROL HAS BEEN ENHANCED THROUGH MODIFIED CORPORATE GOVERNANCE GUIDELINES

The city-owned company sector is comparatively large and is expected to grow further due to the aforementioned anticipated investments by the city owned companies. Göteborgs Stadshus AB (Stadshus AB) is the parent company of all the wholly and part-owned companies. If we include all the contingent liabilities, in the form of self-supporting debt on-lent to the city owned companies, this debt is reported at SEK44.4 billion and would equal 113% of operating revenues in 2016. We anticipate this number to slightly increase following the anticipated investments.

In 2016 the city has on-lent SEK28.9 billion or 89% of its outstanding direct debt (SEK32.6 billion) to companies controlled by the city. In addition, the indirect debt which was issued independently by the companies was reported at SEK7.3 billion (Exhibit 3). Förvaltnings AB Framtiden, a property company, represents the majority of this debt, as they have SEK4.3 billion in outstanding debt, equal to 58% of the companies' outstanding debt (i.e. city's indirect debt). We anticipate the amount of companies' self-borrowed debt to reduce over the next 2 years as city owned companies are no longer allowed to issue new independent own named debt under the modified corporate governance guidelines. This debt is planned to be replaced with the city's on-lent debt.

The modified corporate governance guidelines apply to all city-owned companies and aim to centralise all financing functions for both the City Authority and the city's companies. Since 2013, financing for these companies has taken place through the city with the city on-lending and charging market interest rates to these companies. As a result of this move to bring financing in-house, the city's direct debt increased to SEK32.6 billion in 2016 from SEK22.8 billion in 2013 while indirect debt issued independently by the companies decreased to SEK7.3 billion in 2016 from 17 billion in 2013; the city's net debt, however, has not been affected by this change as we view company owned debt as self-supporting.

With the consolidation of the companies and treasury functions we believe transparency and control over the city's liabilities has increased. The city's centralised financial functions are also likely to improve risk control, giving the city greater control of these city-owned companies. This is a credit positive in an environment of a large company sector anticipated to grow further.

Extraordinary Support Considerations

We assign a very high likelihood of extraordinary support from the [Kingdom of Sweden](#) (Aaa stable), reflecting our assessment of (1) the role of Gothenburg as a major population centre and driver of the economy; (2) the central governments oversight of the regional and local government sector; (3) local governments are required to close budget deficits within three years; (4) the Swedish equalisation system; and (5) Sweden's reputation would suffer if Gothenburg were to experience financial distress.

Output of the Baseline Credit Assessment Scorecard

In the case of the City of Gothenburg, the BCA matrix generates an estimated BCA of aa1, in line with the BCA of aa1 assigned by the rating committee.

The matrix-generated BCA of aa1 reflects (1) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a systemic risk score of Aaa, as reflected in the sovereign bond rating (Aaa stable).

The idiosyncratic risk scorecard and BCA matrix, which generate estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by these tools provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

Rating Methodology and Scorecard Factors

[Regional and Local Governments](#), January 2013 (147779)

Exhibit 4

Gothenburg, City of Baseline Credit Assessment	Value	Sub-Factor Score	Sub-Factor Weighting	Sub-Factor Total	Factor Weight	Total
Factor 1: Economic Fundamentals						
Economic strength	100	5	70%	3.8	20%	0.76
Economic volatility		1	30%			
Factor 2: Institutional Framework						
Legislative background		1	50%	2.0	20%	0.40
Financial flexibility		3	50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	4.4	5	12.5%	2.3	30%	0.68
Interest payments / operating revenues (%)	1.4	3	12.5%			
Liquidity		1	25%			
Net direct and indirect debt / operating revenues (%)	11.1	1	25%			
Short-term direct debt / total direct debt (%)	17.9	3	25%			
Factor 4: Governance and Management						
Risk controls and financial management		1		1	30%	0.30
Investment and debt management		1				
Transparency and disclosure		1				
Idiosyncratic Risk Assessment						2.14 (2)
Systemic Risk Assessment						Aaa
Suggested BCA						aa1

Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
GOTHENBURG, CITY OF	
Outlook	Stable
Senior Unsecured	Aaa
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

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