

Research

Research Update:

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

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Overview

- We do not expect the political uncertainty resulting from recent elections will materially affect Göteborg's fiscal position, given the city's strong financial management, healthy local economy, and ample revenue flexibility.
- We expect management will remain committed to financial policies, prudently manage upcoming debt-financed investments, and keep refinancing risks to a minimum.
- We are affirming our 'AA+/A-1+' issuer credit and 'K-1' Nordic regional scale ratings on Göteborg.
- The outlook is stable.

Rating Action

On Sept. 14, 2018, 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, despite parliamentary uncertainty, high investment levels, and pressure on operating expenditures, management will maintain the city's sound financial position over the next two years. Specifically, we expect it will remain committed to budgetary discipline, and make use of revenue flexibility stemming from the large amount of sellable assets within the company sector if necessary. We also anticipate the city will maintain its prudent debt and liquidity management through 2020, and contract ample backup facilities to keep refinancing risks to a minimum.

Downside Scenario

We could consider lowering the ratings if we observed that a deteriorating political situation was preventing the city from managing upcoming investments and containing pressure on operating expenditures. In this scenario, we would likely observe a more relaxed attitude toward financial policies, which, in

combination with increasing debt, would strain the city's liquidity position.

Upside Scenario

We could raise the ratings if the city reinforced its capacity to contain operating expenditure growth, structurally improved its operating margins to above 5% of revenues, and if we observed a structural improvement of the city's liquidity position.

Rationale

The affirmation reflects our view that Göteborg will maintain a sound fiscal position on the back of budgetary discipline and revenue flexibility, despite high levels of upcoming investments and pressure on expenditures. The very strong and diverse local economy, and the extremely predictable and supportive Swedish institutional framework, further support the ratings. As a result of the upcoming investments, we anticipate direct debt will approach 130% of operating revenues in 2020. We expect the city's financial management will remain prudent, and that it will keep refinancing risks to a minimum by contracting a sufficient amount of back-up facilities to counteract liquidity pressure. In our view, Göteborg's contingency risks will remain low, due to the low risks related to the city's exposure toward the Swedish public sector funding agency Kommuninvest AB, and a relatively low level of extended guarantees.

Despite political uncertainty, we expect the city will maintain strong financial fundamentals

The Swedish institutional framework for local and regional governments (LRGs) is a key factor underpinning our ratings on Göteborg. In our view, the Swedish LRG system is extremely predictable and supportive, with a high degree of stability. The sector's revenue and expenditure management is largely based on an extensive equalization system and autonomy in setting local taxes.

We base our analysis on Göteborg on the Swedish national GDP per capita of \$52,000, with the equalization system effectively evening out wealth among Swedish LRGs. We consider the local economy as strong, even in an international context. Göteborg is the second-largest city in Sweden, and an industrial and regional center that is headquarter to some of the largest companies in the country. Due to its strategic location, the city is a natural hub for international trade. The population in Göteborg has increased significantly over the past few years, at an average 1.4% annually, partly due to immigration. A relatively large share of Göteborg's population was born abroad and, because unemployment is generally higher for this group, the city's unemployment rate, at 7.1% in July 2018, is slightly higher than the national and regional average.

Overall, we consider Göteborg's management to be strong. More specifically, we consider the city's financial management to be prudent and sophisticated, and we expect the city will continue to exercise very strong debt and liquidity

management to deal with its increasing debt. Nevertheless, the political situation during the term prior to the 2018 election was challenging, with the opposition occasionally overruling some of the minority government's budget proposals. Despite this, the overall political situation in Göteborg was relatively stable, owing to consensus regarding some of the major budgetary items. However, because the recent 2018 elections have resulted in an even more fragmented parliament, the situation going forward remains uncertain.

Nevertheless, although the political situation may constrain the city in conducting efficient financial policymaking, and hinder necessary reforms, we anticipate that management will be able to counteract any pressure on budgetary performance through its revenue flexibility.

Very competent financial management will likely contain debt and liquidity risks

Göteborg's operating expenditure is facing increasing pressure, partly due to the rapid population increase of the past few years. We anticipate this will somewhat burden the city's budgetary performance, and we forecast Göteborg's operating balance as a per cent of operating revenues, will decline to an average of 2.4% in 2019-2020, compared with 5.4% in 2017. In addition, the city will need to invest significantly in core infrastructure, such as schools and care homes. Consequently, we expect the deficit after capital expenditure (capex) will average 5.4% in 2019-2020, compared with a surplus of 0.4% in 2017.

To counterbalance expenditure pressure, the city is extracting dividends amounting to Swedish krona (SEK) 767 million (€73 million) in 2017, or almost 2% of operating revenues. We forecast that the city will extract SEK810 million in 2018 and SEK500 million annually in 2019-2020, and that the dividends will likely be debt-financed. In addition, we anticipate Göteborg will continue to benefit from revenues related to land development through 2020 as the city expands. In our view, Göteborg has an institutionalized revenue flexibility, with modifiable revenues estimated at more than 70% of operating revenues, mitigating any significant budgetary deterioration. This is important because of Swedish LRGs' rigid and inflexible expenditure structure. Furthermore, although the dividends extraction is a sign of the incorporated revenue flexibility within the company sector, we do not consider current levels as sustainable in the long term, since it depletes the company sector's financial ability to cope with their own upcoming investments. Instead, we believe management will need to again enforce fiscal discipline in order to curb rising expenditures.

Göteborg is set to make significant investments in the next few years, mainly in core city infrastructure and in the company sector, mainly related to the housing company Forvaltnings AB Framtiden (AA-/Stable/A-1+; Framtiden). We forecast that Göteborg's capex will average SEK4.5 billion per year in 2019-2020, or 9.7% of total expenditure. In combination with estimated onlending of SEK5.3 billion per year to the city's housing company and the regulated water company Gryaab AB, we expect the city's direct debt will reach 129% of operating revenues by 2020, up from 92% in 2017. We assess these

companies as self-supporting, mitigating the debt burden.

In our view, Göteborg's liquidity will remain strong, thanks to the city's strong liquidity buffers, consisting of committed bank and loan facilities and internal liquidity, covering 130% of the coming 12 months debt service. Göteborg has a wide range of funding sources including a SEK6 billion commercial paper program, a €6 billion euro medium-term note program, a \$500 million euro commercial paper program, and loans from Kommuninvest. In addition, the city has loan facilities with the Nordic Investment bank (NIB), European investment bank (EIB), and the Council of Europe development bank (CEB) totaling SEK5.5 billion. We acknowledge in our assessment of Göteborg's liquidity position that, similar to other rated Nordic LRGs, the city has strong and reliable access to external liquidity.

In our calculations, we include SEK8.1 billion of maturing debt and interest. Moreover, because the housing company Framtiden is being integrated into the in-house bank, we add the remaining SEK500 million of outstanding bonds because they will be refinanced by the city treasury. The city has SEK8 billion of committed back-up facilities with major Nordic banks. We also include half of the available, undrawn amount of the loan facilities with EIB, NIB, and CEB, amounting to SEK2.3 billion. In addition, Göteborg has cash and short-term investments amounting to SEK2.4 billion, after appropriate haircuts according to our criteria. The short-term investments consist of SEK3 billion of Swedish covered bonds, or SEK2.1 billion after haircuts, and are held for liquidity purposes only. We observe that the overall funding need within the city and its company group will remain high over the coming years due to large investments, and we acknowledge these funding volumes in our assessment of the city's liquidity.

Göteborg's contingency risk is likely to remain limited. The city is a member of the national public sector funding agency, Kommuninvest, and Göteborg has signed a joint and several guarantee for Kommuninvest's obligations. However, we consider it unlikely that Kommuninvest's operations would falter to the extent that these guarantees would be called upon. We also consider the level of guarantees the city has extended toward other entities and associations as low.

Key Statistics

Table 1

Goteborg (City of)--Key Statistics						
--Year ending Dec. 31--						
(Mil. SEK)	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	36,284.0	39,098.0	40,561.0	41,362.0	42,833.0	44,306.0
Operating expenditures	34,726.0	36,931.0	38,384.0	40,172.0	41,787.0	43,258.0
Operating balance	1,558.0	2,167.0	2,177.0	1,190.0	1,046.0	1,048.0
Operating balance (% of operating revenues)	4.3	5.5	5.4	2.9	2.4	2.4

Table 1

Goteborg (City of)--Key Statistics (cont.)						
	--Year ending Dec. 31--					
(Mil. SEK)	2015	2016	2017	2018bc	2019bc	2020bc
Capital revenues	761.0	807.0	1,595.0	1,410.0	1,100.0	1,100.0
Capital expenditures	3,013.0	2,920.0	3,600.0	4,229.4	4,511.4	4,581.9
Balance after capital accounts	(694.0)	54.0	172.0	(1,629.4)	(2,365.4)	(2,433.9)
Balance after capital accounts (% of total revenues)	(1.9)	0.1	0.4	(3.8)	(5.4)	(5.4)
Debt repaid	8,106.0	7,884.0	5,832.0	7,211.0	9,003.0	8,057.0
Gross borrowings	10,301.0	10,333.0	10,602.0	11,577.0	16,985.0	15,431.0
Balance after borrowings	264.0	(538.0)	155.0	(705.4)	(0.4)	0.2
Modifiable revenues (% of operating revenues)	71.4	70.3	71.5	72.7	73.0	72.8
Capital expenditures (% of total expenditures)	8.0	7.3	8.6	9.5	9.7	9.6
Direct debt (outstanding at year-end)	29,571.0	32,566.0	37,336.0	41,702.0	49,684.0	57,058.0
Direct debt (% of operating revenues)	81.5	83.3	92.0	100.8	116.0	128.8
Tax-supported debt (outstanding at year-end)	34,139.0	37,093.0	42,039.0	46,405.0	54,387.0	61,761.0
Tax-supported debt (% of consolidated operating revenues)	65.3	66.4	72.5	78.5	89.3	98.4
Interest (% of operating revenues)	1.5	1.3	1.2	1.3	1.2	1.2
National GDP per capita (single units)	430,871.8	447,141.9	460,186.4	476,579.0	492,655.5	509,727.9

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. SEK--Swedish krone. 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	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Strong
Budgetary performance	Average
Liquidity	Strong
Debt burden	Moderate
Contingent liabilities	Low

*The ratings of S&P Global Ratings on local and regional governments (LRGs) are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on an LRG.

Key Sovereign Statistics

- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 31, 2018

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sovereign Risk Indicators, July 5, 2018. An interactive version is also available at <http://www.spratings.com/sti>
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 2018
- Increasing Capital Costs Could Test Sweden's Local Governments, Dec. 12, 2017
- S&P Global Ratings Definitions, April 19, 2018
- City Of Gothenburg Receives First Green Evaluation For Municipal Green Bond, With A Score Of E2/67, June 19, 2017
- Swedish Local And Regional Government Risk Indicators: April 2017 Update, April 5, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Public Finance System Overview: Swedish Municipalities And Counties, June 15, 2017

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+
Short-Term Debt	A-1+
Commercial Paper	A-1+
Commercial Paper	K-1

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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. 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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