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## Research Update:

# City of Goteborg Ratings Affirmed At 'AA+/A-1+' And 'K-1'; Outlook Stable

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## Overview

- The City of Göteborg is facing strong expenditure pressures and we expect that the city's management will need to take assertive action through 2019 to sustain overall adequate budgetary performance.
- We also expect Göteborg to maintain its conservative debt and liquidity management in a context of increasing direct debt stemming from centralization of its company sector's funding in 2018 and overall high investments in the municipal group.
- We are affirming our 'AA+/A-1+' issuer credit and 'K-1' Nordic regional scale ratings on Göteborg.
- The stable outlook reflects our expectation that Göteborg will maintain adequate budgetary performance until at least 2019, as well as prudent treasury management that will support continued strong overall liquidity.

## Rating Action

On Sept. 15, 2017, 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 will maintain adequate budgetary performance through 2019. We anticipate increased treasury activities because of a noticeable step-up in funding requirements from increasing municipal capital expenditures, as well as the transfer of housing company debt into the city treasury. Nevertheless, we expect continued prudent debt and liquidity management that is likely to result in liquidity remaining strong over the coming 24 months.

## Downside Scenario

We could consider a downgrade if we observed deteriorating management performance, stemming from an inability to sufficiently contain spending, which, together with faltering capital expenditure planning and lax debt and liquidity management, could lead to strains on liquidity. Consequently, we would expect budgetary performance to deteriorate. In this situation, we could revise downward our view of the city's financial management and liquidity, and consequently lower the ratings.

## Upside Scenario

We could raise the ratings if we observed a strengthening of management, with a consensus on fiscal policies resulting in assertive actions to structurally curb expenditure pressures. In this scenario, we would expect improved revenue and

expenditure control, accompanied by improved budgetary performance. In combination with a strengthening of the city's liquidity to a level we consider exceptional, this could lift our assessments of the city's liquidity and management, and trigger an upgrade.

## **Rationale**

The affirmation reflects our view that Göteborg will continue to benefit from a extremely predictable and supportive institutional framework, strong liquidity, and strong management. Moreover, the city's very strong local economy, strong budgetary flexibility, and low contingent liabilities further underpin the ratings. The city's average budgetary performance and rising, though currently moderate, debt burden balance these positive rating factors. Although we believe that debt-funded investments will result in higher debt over the next three years, we consider management's prudent approach to securing stable debt servicing resources to be central to our base case.

### **A strong institutional framework and wealthy economy, but rising expenditure is set to test fiscal discipline and budget execution**

With more than 500,000 inhabitants, Göteborg is Sweden's second-largest city and the regional center of western Sweden. In an international context, Göteborg's economy is very strong. An expanding services sector and increased diversification have contributed to a more robust macroeconomic structure in recent years. Because of the country's comprehensive equalization system, which evens out the wealth among Swedish local and regional governments (LRGs), we use the national GDP per capita of US\$54,000 as a starting point for our analysis.

We view the Swedish equalization system as extremely predictable and supportive and consider it a key component of our ratings on Göteborg. In our view, the system displays a high degree of institutional stability. The LRG sector's revenue and expenditure management is based on a far-reaching equalization system and autonomy in setting local taxes. In this regard, we assess the city as having overall strong budgetary flexibility, with our estimate of modifiable revenues at 70% of operating revenues over 2017-2019. In our view, Göteborg has institutionalized revenue flexibility to mitigate any significant budgetary deterioration, which is important in light of our assessment of a fairly rigid expenditure structure.

We expect that notable expenditure pressures, in part due to the rapidly increasing population, will increasingly strain Göteborg's budgetary performance. We expect rising core public service spending, leading Göteborg's operating balance to decline to an average of 3.2% over 2017-2019. The rising population will also increase the city's investment needs in the coming years, further accentuated by a number of key infrastructure projects to which it contributes. As such, we expect deficits after capital accounts to widen in the coming years to average 3.8% of total revenues over 2017-2019, compared with an average deficit of only 0.9% over 2015-2016.

We expect the city to extract dividends from its company sector to counterbalance the deficits from increasing expenditures. However, we expect the dividend cash

flows to be debt-funded, resulting in an increase in the city's direct debt. Although we believe the planned extraction of dividends is a signal of the financial flexibility of the overall municipal group, we do not consider it a sustainable way to balance accounts in the long run. As such, we would expect Göteborg's leadership to enforce fiscal discipline and take assertive action to curb the rising expenditure before large imbalances build.

On balance, we consider Göteborg's management to be strong. Since the 2014 election, a minority government has ruled Göteborg, which has added some uncertainty with regards to effective decision-making. For example, during its term in office, the opposition has on several occasions garnered support to overrule certain items of the minority government's budget. Although we observe broad consensus in the main budgetary areas and importantly on the importance of fiscal discipline, which is being enforced by Göteborg's civil servants, we believe that a fragmented political environment, if it persists after the 2018 elections, could prove increasingly uncondusive to efficient economic policy making. This could hinder necessary cost-containment efforts in some key areas. With budgetary challenges on both the operating and capital side, we still believe the incumbent political leadership would use its revenue flexibilities if necessary to balance budgets. A recent example was the decision to extract dividends from the company sector. That said, we do not consider this to be a sustainable solution to balance accounts over the longer term. Comprehensive flexibilities exist in other areas, for example the outright divestment of assets or utilizing the constitutional right to increase income tax outtake.

### **Rising capital expenditures heighten funding needs, but very competent financial management is set to contain risk and ensure strong liquidity**

In assessing the city's debt position, we view our tax-supported debt metric as distorted by the inclusion of the substantial revenues of Göteborg's company sector. We consider the city's direct debt as a better metric for our assessment, reflecting the risk associated with the external loans held in the city treasury. In this regard, the city's increasing investments will cause direct debt to gradually rise until 2019. In addition, the debt in the city treasury continues to increase due to an expanding in-house treasury and onlending functions. By 2018, Göteborg plans to complete the process of gradually assuming the debt stock of its housing company, Förvaltnings AB Framtiden (AA-/Stable/A-1+), into the city treasury. Moreover, Göteborg's funding metrics for 2016 are amplified by Swedish krona (SEK) 3 billion (€315 million) issued for the purpose of acquiring the equivalent amount of Swedish covered bonds, which the city holds for liquidity backup purposes.

As such, we expect that Göteborg's direct debt will increase to 128% of operating revenues by 2019 from 80% in 2015. However, we consider Framtiden to be self-supporting, and view the debt lent to this company as positively affecting our assessment of the city's debt position. We anticipate that the city's management will continue its prudent work in containing the increase in debt as investments increase. Despite this, we expect Göteborg's direct debt to continue increasing beyond 2019 since important infrastructure investment and investments in public real estate to cater for the increasing population will persist, cementing our assessment

of the city's moderate debt burden. We assume that Framtiden's loans will be fully transferred to the city treasury by year-end 2018.

As a member of Sweden's local government funding agency, Kommuninvest i Sverige AB (AAA/Stable/A-1+), Göteborg has signed joint and several guarantees of Kommuninvest's obligations. Currently, we do not envisage a scenario in which Kommuninvest's operations would falter to the extent that these guarantees would be called upon. In addition, Göteborg holds a large company sector relative to its size. However, we consider the city has low contingent liabilities, since the debt of the company sector is already integrated into the city treasury and we assess the need for financial support as limited.

We consider the city's financial management to be very prudent with professional, conservative, and active debt and liquidity management. We expect the city to continue to exercise very strong debt and liquidity management to handle its increasing loan portfolio. Over the past year, the city has become a prominent issuer of green bonds, which has generated significant investor interest and broadened its investor base.

We assess Göteborg's liquidity as strong, owing to the city's ample committed bank facilities relative to its volume of maturing debt and strong access to the market. Göteborg's committed bank facilities amount to SEK11.5 billion. In addition, Göteborg has in place a loan facility of SEK1 billion with the Nordic Investment Bank. The city is in discussions with the Council of Europe Development Bank (CEDB) and the European Investment Bank for additional loan facilities of approximately SEK7 billion in total, of which half of the undrawn amount is accounted for in our liquidity analysis. In addition, the city has a portfolio of Swedish covered bonds of SEK3 billion, held solely for liquidity backup purposes. Aside from the possibility of divestment of these holdings, we observe that these assets could be used for sale and repurchase (repo) transactions at the discretion of an intermediating bank. We include these assets in our calculation of Göteborg's liquidity position after applying a haircut as per our methodology.

As such, in September 2017, Göteborg's cash, liquid assets, and committed bank lines amount to 146% of debt and interest coming due over the following 12 months. Because the city is committed to refinancing the debt of Framtiden with the city treasury, we include these loans in our proxy for the city's upcoming financing needs. We observe that overall funding needs in the company sector are large and we acknowledge these funding volumes in our assessment of the city's liquidity position. Göteborg has a range of funding options that help to reduce refinancing risk. Importantly, as it is continuing the process of centralizing Framtiden's funding in the city treasury, the city has increased its capital market programs. It generally obtains funding through a SEK6 billion commercial paper (CP) program, a €6 billion euro medium-term note program, a US\$0.5 billion euro CP program, and loans from Kommuninvest. Consequently, we acknowledge Göteborg's strong and reliable capital market access in assessing its overall liquidity.

## **Key Statistics**

**Table 1**

<b>City of Goteborg Key Statistics</b>					
	<b>--Fiscal Year End Dec. 31--</b>				
<b>(Mil. SEK)</b>	<b>2015</b>	<b>2016</b>	<b>2017bc</b>	<b>2018bc</b>	<b>2019bc</b>
Operating revenues	36,725.0	39,690.0	41,299.0	43,002.0	44,291.0
Operating expenditures	34,767.0	37,152.0	39,965.5	41,619.0	42,850.0
Operating balance	1,958.0	2,538.0	1,333.5	1,383.0	1,441.0
Operating balance (% of operating revenues)	5.3	6.4	3.2	3.2	3.3
Capital revenues	375.0	436.0	1,270.0	1,310.3	1,000.0
Capital expenditures	3,013.0	2,920.0	3,825.0	4,500.0	4,480.0
Balance after capital accounts	(680.0)	54.0	(1,221.5)	(1,806.7)	(2,039.0)
Balance after capital accounts (% of total revenues)	(1.8)	0.1	(2.9)	(4.1)	(4.5)
Debt repaid	8,106.0	7,884.0	5,832.0	6,317.0	8,573.0
Gross borrowings	10,301.0	10,333.0	15,461.0	13,550.0	16,055.0
Balance after borrowings	278.0	(538.0)	5,449.5	0.0	0.0
Modifiable revenues (% of operating revenues)	70.5	69.2	70.4	70.0	70.3
Capital expenditures (% of total expenditures)	8.0	7.3	8.7	9.8	9.5
Direct debt (outstanding at year-end)	29,571.0	32,566.0	42,195.0	49,428.0	56,910.0
Direct debt (% of operating revenues)	80.5	82.1	102.2	114.9	128.5
Tax-supported debt (outstanding at year-end)	34,139.0	37,093.0	46,695.0	53,928.0	61,410.0
Tax-supported debt (% of consolidated operating revenues)	64.8	65.8	79.6	88.3	97.9
Interest (% of operating revenues)	1.5	1.4	1.5	1.4	1.4
National GDP per capita (SEK)	428,947.0	444,134.0	459,725.0	474,477.0	492,579.0

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.

## 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**

- Kingdom of Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable - September 01, 2017

**Related Criteria And Research**

**Related Criteria**

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - August 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- 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 - October 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

**Related Research**

- Sovereign Risk Indicators - July 06, 2017. An interactive version is available at [www.spratings.com/sri](http://www.spratings.com/sri).
- Swedish Local And Regional Government Risk Indicators: April 2017 Update - April 05, 2017
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions - April 03, 2017
- High Investments Underpin Growing Debt Levels For Swedish Local And Regional Governments - February 10, 2016
- Public Finance System Overview: Swedish Local And Regional Governments - January 21, 2016

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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

	Rating	
	To	From
Goteborg (City of)		
Issuer Credit Rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1	--/--/K-1
Senior Unsecured		
Foreign and Local Currency	AA+	AA+
Short-Term Debt		
Foreign and Local Currency	A-1+	A-1+
Commercial Paper		
Foreign and Local Currency	A-1+	A-1+
Nordic Regional Scale	K-1	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



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Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at [www.standardandpoors.com](http://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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