

CREDIT OPINION

14 August 2018

✓ Rate this Research

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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City of Gothenburg (Sweden)

Update to credit analysis

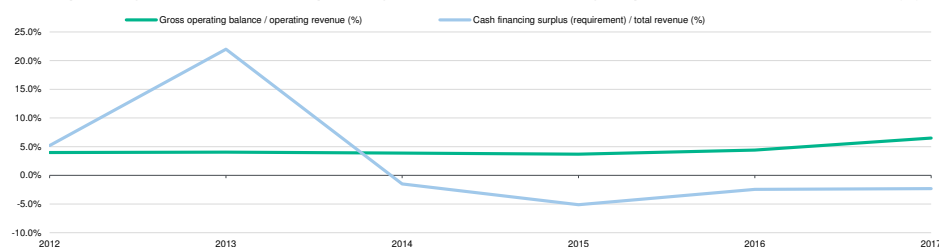
Summary

The credit profile of the [City of Gothenburg \(Aaa, stable\)](#) reflects its robust financial position underpinned by a track record of positive gross operating balances, a supportive institutional framework, the city's role as an industrial hub and its current low net debt levels. It 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. It also reflects our view of a very high likelihood that the [Government of Sweden \(Aaa, stable\)](#) would provide support if the city were to face acute liquidity stress.

Exhibit 1

Relatively stable financial performance with operating surplus, but financing deficit due to investment need

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



Source: Moody's Investors Service

Credit strengths

- » Robust financial performance with positive gross operating balances
- » Strong institutional framework with established equalisation system in a strong economic environment
- » Low level of net debt

Credit challenges

- » Growing population to put pressure on required investment and debt levels
- » Large city-owned company sector forecasted to increase although control has been enhanced through modified corporate governance guidelines

Rating outlook

The outlook is stable. This reflects our forecast that the city is able to maintain its very strong idiosyncratic credit profile, but also takes into account the stable outlook of the sovereign.

Factors that could lead to a downgrade

A downgrade could result from a loosening of the prudent budget discipline, resulting in a significant deterioration of operating performance, or a significant increase in investment levels and consequently debt burden and/or city owned companies ceasing to contribute dividends to the city, or weakening of the importance of local government and consensus with the central government regarding the delivery of public services. A downgrade of the Government of Sweden (Aaa stable), would immediately result in a downgrade for the city.

Key indicators

Exhibit 2

Gothenburg, City of

	2013	2014	2015	2016	2017
Net direct and indirect debt / operating revenue (%)	12.2%	9.0%	10.5%	11.1%	17.4%
Gross interest expenses / operating revenue (%)	3.6%	2.9%	1.6%	1.4%	1.3%
Gross operating balance / operating revenue (%)	4.0%	3.9%	3.7%	4.4%	6.5%
Cash financing surplus (requirement) / total revenue (%)	22.0%	-1.5%	-5.1%	-2.5%	-2.3%
Intergovernmental revenues / total revenue (%)	5.1%	5.5%	6.9%	9.0%	7.8%

Source: Moody's, City of Gothenburg

Detailed credit considerations

The credit profile of the city of Gothenburg 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, at around 4% of operating revenues over the last five years and was relatively strong with 6.5% of operating revenues in 2017 (see Exhibit 1). As a result of increasing population and the need for public services, this ratio is expected to slightly weaken over the next five years. The city budgets a weaker, but still positive operating surplus of 1% for 2018. Based on latest projections, the city would be able to exceed its budgeted numbers.

In 2017, operating revenues were SEK41.6 billion, again a significant increase of 6% from 2016 largely driven by dynamic tax revenues, but also thanks to dividends received. The bulk of Gothenburg's revenues stems from taxes (73%). Intergovernmental transfers, in the form of tax equalisation grants and other central government (general) grants are another revenue source (8%). The remainder of revenues stem from fees and commissions and financial income (including dividends) from city-owned companies (19%).

In 2017, operating expenses were SEK38.9 billion, an increase of 4% from 2016. More than half of operating expenses consist of personnel costs (53%), which are increasing due to rising demand for public services. The remainder includes costs of goods and services (31%), interest expenses (1%) and transfers for financial assistance (3%).

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Strong institutional framework with established equalisation system in a strong economic environment

Swedish 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 national 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 2017 with net earnings of SEK1,304 million (excluding capital gains, but including SEK767 million dividends received), of which SEK1,000 million has 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 2017, equalisation grants were SEK3.8 billion. Other general grants were SEK3.2 billion.

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 financial flexibility is also supported by its strong economic situation, providing a strong tax base. The city 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 Car AB](#) (Ba1 stable), [Stena AB](#) (B1 negative) and [SKF AB](#) (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 the majority of the city's revenues come from local taxes (personal income tax), the strength of the regional economy supports the city's finances.

Gothenburg is the second largest city in Sweden with a population of around 564,000 inhabitants, approximately 5.6% 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.

Low level of net debt

Net direct and indirect debt are calculated at 17.4% (SEK7.2 billion) of operating revenues at year end 2017, and are expected to be around the same level in 2018. This appears slightly higher than previous in years, however, additional debt has been used to build up a considerable highly liquid securities portfolio.

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.

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 in 2013. 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 City's fifth green bond, issued in June 2017, amounted to SEK 1.2 billion, maturing in June 2023. The City's cumulative green bond issuance to date totals SEK 5.56 billion. 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.

Around SEK6 billion of the Municipality's loans (nearly 20% of outstanding debt, including on-lent debt to municipal companies) will mature each year over the next few years. The average duration (incl. derivatives) of their long term debt maturing is around 4 years. 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.

The city has a strong liquidity profile, resulting also from a 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 (SEK1 billion as of year end 2017), the city holds committed bank facilities amounting to SEK8 billion as of year end 2017 which are available with immediate drawdown. In addition, the city holds a liquid securities portfolio (covered bonds) of around SEK3 billion.

Growing population to put pressure on required investment and debt levels

Gothenburg has had rapid population growth for several years. Over the past 10 years, the city's population has grown by 70,000 people (7,400 in 2017). The large increases are due to high birth rates as well as to migration into the city.

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 up to around SEK6 billion annually over the coming years. In addition, the city companies are also planning to invest even higher amounts to address infrastructure needs. We expect these investments to be largely financed via increased debt levels, as operating surpluses are not deemed sufficient to cover annual capital expenses. We will continue to monitor the municipal and city company investments and debt levels. We expect this to continue being managed appropriately moving forward.

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, compared to other Swedish municipalities. Göteborgs Stadshus AB (Stadshus AB) is the parent company of all the wholly and part-owned companies. If we include all the contingent liabilities, including self-supporting debt on-lent to the city owned companies, this debt is reported at SEK46.4 billion and would equal 112% of operating revenues in 2017. We anticipate this number to slightly increase following the anticipated investments. The largest self-supporting, city-owned borrowers are Förvaltnings AB Framtiden (SEK16 billion), Göteborg Energi AB (SEK3.5 billion), and HIGAB (SEK3.6 billion).

In 2017 the city has on-lent SEK30.8 billion (more than 80% of its outstanding direct debt of SEK37.3 billion) to companies controlled by the city.

In addition, the indirect debt which was issued independently by the companies was reported at SEK4.4 billion.

We anticipate the amount of companies' self-borrowed debt to reduce, as city owned companies are no longer allowed to issue new independent own-named debt under the modified corporate governance guidelines. This debt is 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.

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 consider Gothenburg to have a very high likelihood of extraordinary support from the Government 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.

Rating methodology and scorecard factors

The assigned baseline credit assessment (BCA) of aa1 is in line with the scorecard-indicated BCA of aa1.

The matrix-generated BCA of aa1 reflects (i) 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 (ii) a systemic risk score of Aaa, as reflected in the sovereign bond rating for Sweden (Aaa stable).

Exhibit 3

Gothenburg, City of Regional and Local Governments

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 (%)	6.5	3	12.5%	2.0	30%	0.60
Interest payments / operating revenues (%)	1.3	3	12.5%			
Liquidity		1	25%			
Net direct and indirect debt / operating revenues (%)	17.4	1	25%			
Short-term direct debt / total direct debt (%)	14.9	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						2.06 (2)
Systemic Risk Assessment						Aaa
Suggested BCA						aa1

Source: Moody's Investors Service

Ratings

Exhibit 4

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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