

Research Update:

# City of Stockholm Outlook Revised To Stable From Negative; 'AAA/A-1+' Ratings Affirmed

May 14, 2021

## Overview

- City of Stockholm's efforts to contain its increasing debt by reducing capital spending and divesting assets, both in the city and in the company sector, is proceeding according to plan.
- On the back of stronger tax revenue growth and continued budgetary discipline, we expect the city's operating performance will remain resilient in the coming years, which, in combination with robust financial policies, will support its strong liquidity position.
- We therefore revised our outlook to stable from negative and affirmed our 'AAA/A-1+' and 'K-1' ratings.

## Rating Action

On May 14, 2021, S&P Global Ratings revised its outlook on City of Stockholm to stable from negative and affirmed its 'AAA/A-1+' long- and short-term issuer credit ratings. At the same time, we affirmed our 'K-1' Nordic regional scale rating on the city.

## Outlook

The stable outlook reflects our expectation that Stockholm will remain committed to its capital revenue and expenditure plans, both for the city and the company sector, slowing debt build-up in the coming years. In line with economic recovery, we also forecast stronger tax revenue growth, which should mitigate cost pressure through 2023. Furthermore, we expect management will uphold the city's strong liquidity position by adhering to financial policies stipulating a debt coverage ratio in excess of 120%.

## Downside scenario

We could lower our ratings if management changes its strategy concerning debt containment or fails to reduce capital spending and divest nonstrategic assets, resulting in a significant increase in the city's debt beyond our expectations. We could also lower the ratings if long-term systemic

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support to the Swedish local and regional (LRG) sector proves insufficient.

## **Rationale**

We revised our outlook to stable from negative since we expect the city's debt trajectory will stabilize in the next few years, owing primarily to Stockholm's plan to reduce capital spending and divest assets, both within the city and the company sector. Also, owing to improved economic indicators, we expect stronger tax revenue growth, translating into higher operating cash flow and lower borrowing needs. Although we factor in long-term uncertainty about the ability of Swedish LRGs to balance rising spending responsibilities with revenue sources, we acknowledge the supporting nature of the institutional framework. We observe that the central government has provided substantial financial aid to LRGs during the COVID-19 pandemic.

### **The central government has provided extensive support to the LRG sector during the pandemic, but structural issues remain unresolved**

We consider the institutional framework in Sweden extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the LRG sector's revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. The central government's swift response to the pandemic, partly through the distribution of general grants to the sector, further supports our view.

However, before the outbreak of COVID-19, the sector's budgetary performance had structurally deteriorated due to increasing expenditure, accentuated by central government policymaking, insufficient compensation mechanisms, and LRGs' inadequate countermeasures. Furthermore, how the central government aims to address the sector's demographic challenges, and to what extent it should provide financial support, are unclear. Consequently, we assess the institutional framework as weakening.

In our view, Stockholm has very strong management. The political landscape is stable, supported by a majority coalition committed to financial sustainability. The city's debt containment strategy remains a key priority. At the same time, the city has a track record of budgetary discipline, demonstrated by the city committees' strict cost-control. Furthermore, we consider the treasury team as highly competent and experienced, supported by risk-minimizing financial policies and robust follow-up procedures.

Stockholm benefits from Sweden's strong economic fundamentals, reflected in our 2021 estimate of national GDP per capita of \$59,700. Although the pandemic has had a significant impact on Stockholm, we believe the city is in a favorable position to take advantage of the economic recovery owing to its dynamic and well-diversified labor market. Furthermore, the city benefits from being the financial center in the Nordics and the home of many of Sweden's largest companies.

### **Continued government support and strong tax revenue growth, alongside the plan to reduce capital expenditure (capex) and divest assets, will mitigate the city's debt accumulation**

Despite the adverse economic effects of the pandemic and gradually reducing extraordinary government support, we expect Stockholm will post resilient operating margins through 2023. Since the virus spread to Sweden, the central government has introduced unprecedented support

packages to the LRG sector, especially in 2020, primarily through extraordinary general grants. Similarly, the central government has provided extensive support to the labor market, partly through employment schemes, which, combined with Sweden's robust unemployment benefit system, has shielded tax-revenue growth. Moreover, the central government has compensated for extraordinary COVID-19-related costs, while reduced activity due to the pandemic has led to lower expenditure than expected for some committees. Consequently, in line with the sector as a whole, Stockholm reported very strong operating results in 2020.

We forecast the city's performance metrics will normalize in 2021-2023, given temporary government support implemented to address the immediate impact of the pandemic will disappear once the situation stabilizes. However, a share of the government grants announced last year were made permanent, and additional support to the elderly care sector was announced as part of the central government's 2021 Budget Bill. At the same time, we expect persisting pressure from demographic-related expenditure, although management will remain committed to budgetary discipline. Still, our base case points to a deterioration in the city's performance metrics, with operating balances falling below 5% in 2022 and 2023.

In line with our previous review, we project a reduction in the city's capex over the forecast period (including the borrowing needs of the school property company SISAB) compared with the past two years. This trajectory reflects the revised capex plan, which, in tandem with a steady inflow of capital revenue, will improve the city's deficit after capital accounts in the coming years.

Furthermore, we expect lower borrowing needs from the city's companies on the back of lower investment levels, stemming from stricter prioritizations. We also anticipate increased revenue from asset sales, mainly related to the city's real estate and housing companies. Consequently, we expect slower debt accumulation in the coming years, with direct debt reaching 111% of operating revenue in 2023.

Debt and liquidity management for the city and the company sector is managed by the in-house bank. The totality of the city's external debt is attributable to on-lent funds to the companies, with the real estate companies, the water and waste company, and the harbor being the largest borrowers. We consider on-lending to housing companies and the water and waste company mitigates the city's overall debt burden, owing to their strong business profiles and financial positions. Adjusted for their relative share of the company sector's liability toward the city, Stockholm's debt would be about 42% of operating revenue. Furthermore, we regard the city's contingent liabilities, including extended guarantees and its ownership in Stockholm Exergi, as limited.

On July 31, 2020, Finnish power group Fortum, which owns 50% of Stockholm Exergi Holding AB (publ) (Stockholm Exergi; BBB+/Stable/A-2) together with the city of Stockholm, announced it will strategically assess its stake in the company. In December, Stockholm decided to maintain its holding at 50% and not enter into negotiations to acquire Fortum's stake. Consequently, under our base case, we consider it unlikely that the city would become a 100% owner of Stockholm Exergi.

In our view, Stockholm's revenue flexibility is stronger than that of peers, owing to a low tax-rate (fourth lowest in Sweden) in combination with ability and declared willingness to divest assets to support financial sustainability. The city's property companies sit on substantial surplus values in their asset portfolios, and the interest from prospective buyers is generally high due to Stockholm's favorable market fundamentals.

Stockholm's liquidity position remains strong, and we estimate the city's sources will cover about 212% of average debt service in the coming 12 months. In our view, the city has prudent liquidity policies in place, and we expect the city treasury will counterbalance pressure on its liquidity position by contracting additional facilities if needed to maintain the coverage ratio above 120%,

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as debt maturities increase in 2022 and 2023. Moreover, in line with other rated Swedish LRGs, the city benefits from strong and reliable access to capital markets, even during strained credit conditions, as seen during the most tumultuous period of the pandemic last year.

## Key Statistics

Table 1

### Stockholm (City of) Selected Indicators

	Fiscal year end Dec. 31					
	2018	2019	2020	2021bc	2022bc	2023bc
Selected Indicators						
Operating revenues	59,129	59,680	62,125	63,327	64,328	65,496
Operating expenditures	56,075	56,930	57,079	59,688	61,281	62,450
Operating balance	3,054	2,750	5,046	3,639	3,047	3,045
Operating balance (% of operating revenues)	5.2	4.6	8.1	5.7	4.7	4.6
Capital revenues	3,221	2,943	2,951	2,250	3,150	3,150
Capital expenditures	8,651	9,037	8,127	6,440	6,418	6,443
Balance after capital accounts	-2,376	-3,344	-130	-551	-221	-248
Balance after capital accounts (% of total revenues)	(3.8)	(5.3)	(0.2)	(0.8)	(0.3)	(0.4)
Debt repaid	5,462	5,627	9,741	3,162	8,436	8,874
Gross borrowings	14,116	14,511	15,902	6,728	12,080	11,283
Balance after borrowings	520	-50	0	50	0	0
Direct debt (outstanding at year-end)	48,217	57,101	63,263	66,829	70,473	72,882
Direct debt (% of operating revenues)	81.5	95.7	101.8	105.5	109.6	111.3
Tax-supported debt (outstanding at year-end)	48,217	57,101	63,263	66,829	70,473	72,882
Tax-supported debt (% of consolidated operating revenues)	66.5	78.2	83.7	86.7	89.9	91.3
Interest (% of operating revenues)	0.7	0.7	0.7	0.7	0.7	0.7
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	477,094	491,200	479,449	497,941	518,171	537,124

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. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

## Ratings Score Snapshot

Table 2

### City of Stockholm Ratings Score Snapshot

Key rating factors

Table 2

### City of Stockholm Ratings Score Snapshot (cont.)

Institutional framework	1
Economy	1
Financial management	1
Budgetary performance	2
Liquidity	1
Debt burden	2
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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

- Sovereign Risk Indicators, April 12, 2021. An interactive version is available at [www.spratings.com/SRI](http://www.spratings.com/SRI).

## 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: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Institutional Framework Assessments For International Local And Regional Governments, April 13, 2021
- Default, Transition, and Recovery: 2019 Annual International Public Finance Default And Rating Transition Study, Dec. 8, 2020
- Extra Funding In Sweden's 2021 Budget Will Support LRGs, Sept. 24, 2020
- COVID-19: Fiscal Response Will Lift Local And Regional Government Borrowing To Record High, June 9, 2020
- COVID-19 Could Further Strain Swedish LRGs' Budgets, May 20, 2020
- Swedish Government To Mitigate Impact From Coronavirus On Local And Regional Governments, March 11, 2020
- Public Finance System Overview: Swedish Municipalities And Regions, Dec. 3, 2019

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- Stockholm Exergi Holding AB (publ), July 3, 2020

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

### Outlook Action; Ratings Affirmed

	To	From
<b>Stockholm (City of)</b>		
Issuer Credit Rating	AAA/Stable/A-1+	AAA/Negative/A-1+
Nordic Regional Scale	--/--/K-1	--/--/K-1
Senior Unsecured	AAA	AAA
Commercial Paper	A-1+	A-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](http://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/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website 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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