

Research Update:

# City of Stockholm Ratings 'AAA/A-1+' Ratings Affirmed; Outlook Remains Negative

November 13, 2020

## Overview

- We now expect central government support will shield Stockholm's tax-revenue growth, which combined with increased government grants will support strong, yet gradually weakening, performance over the coming two years.
- Although the city's efforts to contain its increasing debt is proceeding according to plan, we still believe the economic downturn could dent the city's ability to divestment assets and reduce investments.
- We are therefore maintaining our negative outlook on Stockholm, while affirming our 'AAA/A-1+' global scale issuer credit ratings and 'K-1' Nordic regional scale rating on the city.

## Rating Action

On Nov. 13, 2020, S&P Global Ratings affirmed its 'AAA/A-1+' long- and short-term issuer credit ratings on the city of Stockholm. The outlook remains negative.

At the same time, we affirmed our 'K-1' Nordic regional scale rating on Stockholm.

## Outlook

The negative outlook reflects the risk that the city's leadership might fail to contain Stockholm's rising debt stemming from large investment needs. A debt increase could, for instance, emanate from the COVID-19-induced economic downturn or large one-off investments in the medium term. This could, in our view, impair the city's ability to withstand a 'AAA' stress scenario.

## Downside scenario

We could lower our ratings on Stockholm over the coming 18 months if the economic downturn or large one-off expenditure dents the city's prospects of maintaining strong cash flows, including proceeds from asset sales; and reducing capital spending, resulting in a significant increase of the

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city's debt beyond our expectations. We could also lower the ratings if long-term systemic support to the sector remains insufficient.

### **Upside scenario**

We could revise the outlook to stable if the city remains committed to its fiscal strategy and manages to implement key infrastructure projects without a rapid accumulation of debt.

### **Rationale**

We now forecast Stockholm will post relatively strong operating performance over the coming two years. This is because the city benefits from extensive central government support, including increased government grants, and stronger tax-revenue growth than we previously expected. We expect Stockholm will remain committed to its strategy on containing the increasing debt burden by divesting nonstrategic assets and prioritizing investments. That said, we believe the pandemic could potentially disrupt the city's plans.

On July 31, Finnish power group Fortum, which owns 50% of Stockholm Exergi Holding AB (publ) (BBB+/Stable/A-2) together with Stockholm, announced it will strategically assess its stake in the company, including a potential divestment. The city has not yet stated its position regarding the company in relation to Fortum's announcement. We will closely monitor how the company's ownership structure develops, since the outcome could have a significant impact on our forecasts for Stockholm.

### **Extraordinary government support mitigates risks from the pandemic, although long-term risks remain**

The city's administration remains committed to financial sustainability, as shown for instance by its debt-containment strategy. Although Stockholm's budgetary conditions have strengthened thanks to increased government grants, we expect the city to act prudently to contain spending and maintain a sound fiscal position through 2022.

We consider the institutional framework to be generally supportive of Swedish local and regional governments (LRGs), but regard this trend as weakening. In recent years, the Swedish LRG sector's budgetary performance has deteriorated due to increasing expenditure--accentuated by central government policymaking--alongside insufficient central government compensation mechanisms and inadequate countermeasures by the LRGs. Nevertheless, we believe the institutional framework remains a key credit strength for Swedish LRGs. In our view, the framework displays a high degree of stability, and the sector's revenue and expenditure management are based on a far-reaching equalization system and autonomy in setting local taxes. Furthermore, the central government's swift response to the COVID-19 pandemic, illustrated for instance by increased grants, supports our opinion.

Stockholm benefits from Sweden's comparably high wealth, reflected in our estimate of 2020 national GDP per capita at a high \$51,500. So far, the Swedish economy has been relatively resilient, and we forecast GDP will contract by about 5.0% in 2020, compared with 7.4% in the eurozone. To date, the capital region of Stockholm has been hardest hit in Sweden by the pandemic, with unemployment rising to 9.1% in September 2020 from 6.2% at year-end 2019. We believe the city's local economy remains strong and resilient, due to its diversity as a financial center in the Nordics and the home of many of Sweden's largest companies, which we believe will

be key in the recovery after the pandemic.

## **Government support has eased the pressure on operating performance, although the pandemic could disrupt the city's plan to contain rising debt**

Compared with six months ago, we now expect Stockholm will post stronger, yet gradually decreasing, operating results through 2022. We believe Stockholm will benefit from increased central government grants and relatively strong tax-revenue growth. We also forecast lower expenditure growth in 2020, partly because the central government will compensate the city for COVID-19 related health care expenditure. Consequently, we believe Stockholm will post very strong results in 2020. We believe grant transfers will gradually reduce over the forecast period, and the city will continue to receive lower dividends from its subsidiaries, leading to slower growth of operating revenue in 2021 and 2022. This, combined with higher operating spending, partly related to higher welfare expenditure, will weigh on Stockholm's operating margin.

We forecast the city will post smaller deficits after capital accounts in 2020-2022 compared with the past two years. This will reflect Stockholm's asset-management strategy, implying stricter prioritization of investments, and divestment of nonstrategic assets. Subsequently, we expect lower capital spending for both the city (including the borrowing needs of the school property company SISAB) and its subsidiaries. We understand the divestment of nonstrategic assets relates mainly to the real estate and housing companies.

We believe this supports our view that Stockholm benefits from above-average revenue flexibility, owing mainly to its ability and willingness to divest assets to support fiscal sustainability, but also to its low tax rate (the fourth lowest in Sweden). The market value of Stockholm's real estate assets alone is estimated to exceed Swedish krona (SEK) 200 billion (about \$21 billion) as of Dec. 31, 2019. In addition to real estate, the city owns one of Sweden's largest harbors and has a 50% share in the energy company Stockholm Exergi.

Despite reduced borrowing needs, we expect the city's debt will increase to relatively high levels in 2022, although slower than a few years ago, thanks to management's efforts on prioritizing investments and divesting assets. That said, weakened economic conditions since the pandemic began could impair the city's ability to divest assets and contain debt.

Stockholm has lent the proceeds of its outstanding debt to its companies. We consider that borrowings by the housing companies and water and waste company mitigate the city's relatively high debt burden, owing to the companies' strong business profiles and financial positions. Adjusted for their relative share of the company sector's liability toward the city, we estimate Stockholm's debt totals about 45% of operating revenue. Furthermore, we regard the city's contingent liabilities, including extended guarantees and its ownership of Stockholm Exergi, as limited.

As we expected, Stockholm's liquidity position has structurally improved. We estimate the city's liquidity sources will cover average upcoming debt service by more than 200% over the next 12 months. In our view, Stockholm has prudent liquidity policies in place, and we expect the city treasury to counterbalance any liquidity pressure as maturities increase in 2022. Moreover, like other Swedish LRGs, Stockholm benefits from strong and reliable access to capital markets, even during strained credit conditions.

As liquidity sources, we include SEK11.8 billion of cash, contracted and available facilities with banks and multilateral lending institutions, and capital cash inflows, including from SISAB. Furthermore, we estimate the city will pay an average of about SEK4.8 billion of maturing debt and interest over the coming 12 months.

## Key Statistics

Table 1

### City of Stockholm Selected Indicators

Mil. SEK	--Year ended Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenue	56,667	59,129	59,680	61,412	63,202	63,758
Operating expenditure	53,616	56,075	56,930	57,874	59,626	60,818
Operating balance	3,051	3,054	2,750	3,538	3,575	2,940
Operating balance (% of operating revenues)	5.4	5.2	4.6	5.8	5.7	4.6
Capital revenue	4,944	3,221	2,943	2,500	3,150	2,800
Capital expenditure	7,499	8,651	9,037	7,679	6,408	7,145
Balance after capital accounts	496	(2,376)	(3,344)	(1,641)	318	(1,404)
Balance after capital accounts (% of total revenues)	0.8	(3.8)	(5.3)	(2.6)	0.5	(2.1)
Debt repaid	5,399	5,462	5,627	10,487	3,162	8,436
Gross borrowings	7,917	14,116	14,511	17,894	5,834	12,876
Balance after borrowings	364	520	(50)	50	0	(0)
Direct debt (outstanding at year-end)	38,655	48,217	57,101	64,508	67,180	71,620
Direct debt (% of operating revenues)	68.2	81.5	95.7	105.0	106.3	112.3
Tax-supported debt (outstanding at year-end)	38,655	48,217	57,101	64,508	67,180	71,620
Tax-supported debt (% of consolidated operating revenues)	55.7	66.5	78.2	86.2	87.5	92.2
Interest (% of operating revenues)	0.8	0.7	0.7	0.6	0.7	0.8
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	462,734	477,094	490,830	471,139	496,002	515,648

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. N/A--Not applicable.

## Ratings Score Snapshot

Table 2

### City of Stockholm Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1

Table 2

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

Key rating factors	Scores
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, Oct. 12, 2020. An interactive version is available via [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

- Extra funding in Sweden's 2021 Budget will Support LRGs, Sept. 24, 2020
- European Local And Regional Government Risk Indicators, June 30, 2020
- COVID-19: Fiscal Response Will Lift Local And Regional Government Borrowing To Record High, June 9, 2020
- Stockholm Exergi Holding AB (publ), June 3, 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
- Sweden's Local Governments To Get A Slight Boost From 2020 Budget, Sept. 20, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default Study And Rating Transition Study, Aug. 19, 2019

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- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019

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

#### Stockholm (City of)

Issuer Credit Rating	AAA/Negative/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AAA
Commercial Paper	A-1+

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