

Research Update:

# Swedish Municipality of Nacka Affirmed At 'AAA/A-1+'; Outlook Stable

August 16, 2024

## Overview

- We forecast Nacka will demonstrate broadly stable budgetary performance due to cost-containment measures, mitigating lingering cost pressure from inflation.
- Nacka's management is adapting its capital expenditure (capex) plans to lower than previously expected population growth.
- Nacka's tax-supported debt is expected to increase to 43% by 2026 from 25% in 2023, reflecting investment needs in infrastructure, which also includes its water- and wastewater company.
- We affirmed our 'AAA/A-1+' long- and short-term ratings on Nacka. The outlook is stable.

## Rating Action

On Aug. 16, 2024, S&P Global Ratings affirmed its 'AAA/A-1+' long- and short-term issuer credit ratings on the Municipality of Nacka. The outlook is stable.

## Outlook

The stable outlook reflects our expectation that Nacka will mitigate risks associated with demographic changes and infrastructure investment needs.

## Downside scenario

We could consider a downgrade if budgetary performance weakens significantly more than we expect, or debt metrics deteriorate materially. This could, for instance, happen if Nacka fails to impose sufficient cost-containment measures or if capex rises significantly above our expectations.

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## Rationale

Our ratings on Nacka are supported by our expectation that proactive cost management and prudent planning will result in ongoing robust cash flow-based operating performance. We expect the municipality's investments, including the financing needs of the municipal company sector, to drive a gradually expanding debt burden in our forecast period until 2026. Furthermore, we expect Nacka to maintain its favorable liquidity position, supported by ample reserves of contracted facilities and strong access to external financing.

## Sweden's extremely supportive institutional framework reduces local and regional government (LRG) sector risks, while Nacka's local economy benefits from a strong demographic profile

We consider the institutional framework for Swedish LRGs as extremely predictable and supportive. 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 tax autonomy. Historically, the central government has provided extensive support to the LRG sector, for example through additional grants distributed in response to the pandemic or, more recently, to cover rising pension costs (for more information, see "Swedish Municipalities And Regions Have Flexibility To Balance Costs," published Nov. 29, 2023, on RatingsDirect).

Nacka benefits from Sweden's comparably high personal income levels and resilient economy, reflected in our estimate of 2024 national GDP per capita at about \$59,600. Furthermore, the local economy in Nacka is in many aspects stronger than the Swedish average. This is largely explained by its close integration with the Stockholm region and its favorable socioeconomic profile, illustrated by residents' relatively high incomes and a strong employment structure compared with domestic peers'. While both national and local population forecasts have recently been revised downward due to low birth rates and significantly lower immigration, we nevertheless expect Nacka's population growth to remain above the national average.

The municipality has a track record of prudently managing its expenditure and implementing necessary policy reforms. We also note some recent improvement in Nacka's financial steering exemplified by more refined and conservative limits for budgeting capex to meet updated population forecasts. We understand that from 2025, Nacka will no longer include any revenue from land sales in its budgets, even when sales are likely to occur. In addition, Nacka's management is contemplating tightening its internal financial controls, including increasing its surplus target.

Nacka benefits from a stable political situation. Since elections in September 2022, the municipality is governed by a center-right minority government, with support from The Green Party. We do not expect the cross-block collaboration to disrupt Nacka's operations or strategies. Furthermore, we think there is political support for fiscal measures proposed by management, including increasing its internal surplus goal or adjusting its local tax rate if deemed necessary.

## Investment in water- and wastewater related infrastructure could add fiscal risks

We note the generally rising investment need for the Swedish water- and wastewater sector, triggered by capacity issues, renovation needs, and enhanced environmental standards. We

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consider water- and wastewater as a core municipal responsibility and, when conducted through a company, we view it as a substitute for direct municipal investment. To allow better comparability between rated Swedish municipalities, we consider Nacka's investments at the water- wastewater company level (Nacka Vatten och Avfall) in our assessment of budgetary performance. Presently, this approach has limited impact on Nacka's budgetary performance, as we expect the annual investment will be equal to about 2% of total revenue. Should the investment level increase significantly beyond our forecast period, it could result in a weaker budgetary performance assessment.

We also no longer consider onlending to Nacka Vatten och Avfall to be a mitigating factor that improves our view on Nacka's debt burden. This reflects our view that as the water- and wastewater sector in Sweden embarks on a heightened investment period, mostly debt financed, the sector's credit quality would likely erode. As a result, our analysis on Nacka is also comparable with those municipalities that conduct water- and wastewater activities within their own balance sheets or those that integrate such activities in their energy companies.

We project Nacka will maintain operating balances higher than 5% through 2026, supported by robust tax revenue growth and expected gradually decreasing pressure from inflation. Tax revenues are being held up by continued growth in the national tax base and, in the case of Nacka, continued population growth. That said, given lower than previously expected population growth, we expect the municipal boards to readjust their previous expenditure plans accordingly. They will do this by appropriately cutting operating costs and consolidating the size of their operations to align with lower than expected population growth.

We expect deficits after capital accounts to return to structurally lower levels in 2025-2026 after temporarily widening in 2024. We note that the current slowdown in population growth and worsened market conditions in the real estate and construction sectors will most likely lead to a significant scaling down of Nacka's investment plans. Furthermore, Nacka has historically managed to contain its budgetary performance by inflows from asset sales. However, in line with our expectation of lower capex, we now forecast only limited asset sales, but acknowledge that Nacka's post-capex balance could improve and borrowing needs reduce if asset sales were to materialize at higher amounts.

Because of the municipality's and its company sector's growing debt financing, we expect tax-supported debt to reach 43% by 2026. Furthermore, as explained earlier, our assessment of Nacka's debt now incorporates loans to its subsidiary Nacka Vatten och Avfall.

Regarding exposure to higher interest, we note that Nacka will be largely reimbursed for rising interest costs by its municipal-owned GREs, to which it has on-lent much of its debt. Moreover, Nacka's exposure to contingent liabilities is limited and we see the risk of materialization as low.

The municipality's liquidity position remains exceptional, and we estimate that available liquidity will cover 296% of upcoming average annual debt service. Sources total about Swedish krona (SEK) 2 billion of cash and committed backup facilities, while uses include maturing debt and interest payments. We expect commercial paper will finance a limited share of debt maturities in the coming years. Like other rated LRGs in Sweden, we consider Nacka to have strong access to external liquidity, thanks to its established relationships with capital markets and financial institutions.

## Key Statistics

Table 1

### Municipality of Nacka--Selected Indicators

SEK. Mil.	--Fiscal year ended Dec. 31--					
	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenues	7,488	7,867	8,172	8,421	8,627	8,941
Operating expenditures	6,890	7,347	7,589	7,922	8,126	8,308
Operating balance	598	520	582	499	501	634
Operating balance (% of operating revenues)	8.0	6.6	7.1	5.9	5.8	7.1
Capital revenues	245	319	382	411	523	459
Capital expenditures	878	863	1,311	1,373	1,271	1,168
Balance after capital accounts	(35)	(25)	(347)	(464)	(248)	(75)
Balance after capital accounts (% of total revenues)	(0.5)	(0.3)	(4.1)	(5.2)	(2.7)	(0.8)
Debt repaid	0	0	350	700	400	400
Gross borrowings	0	200	1,000	1,529	1,055	881
Balance after borrowings	(165)	(277)	(13)	29	0	0
Direct debt (outstanding at year-end)	1,350	1,550	2,200	3,029	3,684	4,166
Direct debt (% of operating revenues)	18.0	19.7	26.9	36.0	42.7	46.6
Tax-supported debt (outstanding at year-end)	1,389	1,583	2,230	3,059	3,714	4,195
Tax-supported debt (% of consolidated operating revenues)	17.8	18.9	25.3	33.7	40.0	43.6
Interest (% of operating revenues)	0.1	0.2	0.5	1.0	1.3	1.3
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	526,517	561,139	589,840	605,836	626,891	647,406

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.

## Ratings Score Snapshot

Table 2

### Municipality of Nacka--Ratings score snapshot

#### Key rating factors

Institutional framework	1
Economy	1
Financial management	2

Table 2

### Municipality of Nacka--Ratings score snapshot (cont.)

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

- Sweden, April 29, 2024

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Nordic Public Finance Credit Outlook 2024: A Mixed Picture, May 16, 2024
- Institutional Framework Assessments For Local And Regional Governments Outside Of The U.S., April 8, 2024
- Subnational Debt 2024: Focus on Debt Sustainability, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Subnational Debt 2024: Global LRGs Can Handle Rising Interest Expenses, Feb. 29, 2024
- Institutional Framework Assessment: Swedish Municipalities And Regions Have Flexibility To Balance Costs, Nov. 29, 2023
- Sweden's Local And Regional Governments Have Less Room To Maneuver Over The Next Year As Pension Costs Rise, Sept. 14, 2023

In accordance with our relevant policies and procedures, the Rating Committee was composed of

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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

#### Municipality of Nacka

Issuer Credit Rating AAA/Stable/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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourcelid/504352>. Complete ratings information is available to RatingsDirect subscribers 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.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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