

Swedish City of Malmö Ratings Affirmed At 'AAA/A-1+' And 'K-1'; Outlook Stable

Primary Credit Analyst:

Carina Johansson, Stockholm (46) 8-440-5918; carina.johansson@spglobal.com

Secondary Credit Analyst:

Gabriel Forss, Stockholm (46) 8-440-5933; gabriel.forss@spglobal.com

OVERVIEW

- We expect Malmö will prudently manage its growing treasury function and maintain exceptional liquidity on the back of continued conservative debt and liquidity management.
- We also expect the city will continue to use its flexibilities while maintaining its conservative approach to capital expenditure planning, supporting strong budgetary performance in 2017-2019.
- We are therefore affirming our 'AAA/A-1+' and 'K-1' ratings on Malmö.
- The stable outlook reflects our expectation that Malmö will maintain strong budgetary performance overall, and continue to exercise prudent debt and liquidity management, thereby maintaining its exceptional liquidity position.

RATING ACTION

On June 2, 2017, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the Swedish City of Malmö. The outlook is stable.

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

OUTLOOK

The stable outlook reflects our expectation that, in light of its expanding treasury function, Malmö's management will continue to exercise prudent debt and liquidity management, so that its liquidity position will remain exceptional. We also

anticipate that Malmö will successfully curtail investment volumes in 2017-2019, thereby limiting average deficits after capital accounts to below 5% of total revenues on average over this period.

Downside Scenario

We could take a negative rating action on Malmö if, in our view, its financial management weakened significantly, demonstrated by a marked deterioration of budgetary performance as a result of higher-than-expected capital expenditures, coupled with an absence of corrective measures, or by depleted liquidity compared with our base-case scenario.

RATIONALE

The affirmation reflects our opinion that the risks to the ratings are balanced. Malmö benefits from a diversified local economy and the strength and stability of the Swedish equalization system. The city's financial management is experienced and prudent and the liquidity position is exceptional, including our view of strong access to external liquidity. The city continues to show strong budgetary performance as a result of strict budgetary discipline together with inflow of some additional subsidies. This results in only moderate financing needs after capital expenditures of 2.5% of revenues on average over 2017-2019, despite growing investment needs for infrastructure resulting from a fast-growing population. To accommodate the growing population, city-owned companies are also experiencing increasing investment needs, largely in new housing construction and in water and sewage. The main share of lending is centered around Malmö's housing company MKB Fastighets AB (AA/Stable/A-1+), which has scaled up the level of new production for the coming years and will require continued lending from the city, putting the city's tax-supported debt on an upward trajectory, although from a currently modest level. The city's financial flexibility is average, stemming from a somewhat lower share of modifiable revenues compared with Swedish peers. However, the city has only low contingent liabilities.

Malmö benefits from the stability of Sweden's equalization system and from very strong management

Malmö's economy is wealthy in an international comparison, and is furthermore boosted by the city's close integration with the Öresund region and Denmark's capital, Copenhagen. However, owing to the comprehensive equalization system within the Swedish institutional framework, which evens out wealth among Swedish local and regional government's (LRGs), we use the national GDP per capita of \$54,000 as the starting point for our analysis. We view the Swedish equalization system as extremely predictable and supportive, and consider it a main component of our ratings on Malmö. In our view, Sweden's LRG 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 2015, Malmö received a large number of refugees, which posed significant organizational and practical challenges, particularly regarding the provision of adequate public services. As a result of more rigid mobility conditions across Europe, together with the Swedish central government's introduction of border controls between Denmark and Sweden, we note that the number of asylum seekers has dropped significantly. Although border controls were recently removed, we have yet to see any significant increase in asylum seekers. Following the large inflow of asylum seekers in 2015, we note that increased costs are being well covered by state grants. Moreover, the central government has announced that this grant is now permanent and will recur every year. That said, Malmö has a fast-growing population stemming from strong internal growth, immigration, and urbanization. We expect it will increase by 1.6% yearly on average over the coming two years, compared with the national average of 1.4%. The demographic composition of Malmö is also changing, with increasing numbers of children and the elderly. Although we do not anticipate any financial pressure for Malmö at present, the city could face challenges in the future, with mounting investment needs for preschools, elementary schools, and housing, as well as practical and organizational hurdles, including recruitment of personnel such as teachers.

We view Malmö's financial management as very strong. We regard it as competent, conservative, and effective at maintaining strong budgetary performance by upholding strict budget discipline. We observe that management is becoming more conservative in its planning of municipal capital expenditures, and has placed a greater focus on debt sustainability and planning over the long term, which we view as positive.

Strong operating balances curtail borrowing needs for investments

We believe that Malmö will continue to show strong operating balances, averaging 6.5% of operating revenues over 2017-2019, owing to the city's commitment to maintaining strict budget discipline. This is largely in line with operating balances we have observed over the past three years. We note that central government grants seem to adequately cover additional costs. However, in 2016, budgetary performance was also boosted by revenues related to the development and sale of land, and by a central government grant given to municipalities with a high level of new housing construction, and some additional subsidies. We believe the grant for new housing is likely to continue in the coming years.

Although we expect increasing investment needs in Malmö to accommodate the growing and changing demographics, for 2017-2019, we expect Malmö will follow through on its intention to actively limit municipal capital spending to major projects only, and continue its goal of debt sustainability. Therefore, in our base case, we assume the city's investments will be lower than the budgeted levels, which will decrease its short-term financing needs. We expect the deficit after capital accounts will average 2.4% of total revenues in 2017-2019.

Malmö's budgetary flexibility is average. In our view, Malmö has institutionalized revenue flexibility to mitigate any significant budgetary deterioration, which is important in light of our assessment of the city's fairly rigid expenditure

structure. Malmö has also recently used this flexibility by divesting assets in its housing company MKB Fastighets, which we assess as positive.

We assess Malmö's debt burden as low, even though debt is increasing owing to moderate deficits after capital expenditures and funding needs of the municipal companies. Most of the city's debt is lent on to self-supporting housing subsidiary MKB Fastighets, which borrows only through the city's in-house bank. Apart from direct debt, the city's tax-supported debt also includes some minor guarantees extended to Malmö's non-self-supporting subsidiaries and external associations. As such, as of 2019, we forecast Malmö's tax-supported debt will represent a modest 60% of consolidated revenues.

Apart from its ownership of MKB Fastighets, Malmö has low contingent liabilities, mostly related to the city's guarantees of self-supporting entities.

We assess Malmö's liquidity as exceptional since the city has sound internal liquidity, ample committed bank facilities relative to volumes of maturing debt, and strong access to the market. Malmö's liquidity sources comfortably cover its liquidity outflows; we estimate that the city's cash and available committed bank facilities represent 144% of debt maturing over the next 12 months, including our proxy of financing needs for municipal investments. Since our last review, Malmö has increased its volumes of committed liquidity facilities to keep pace with its expanding treasury activities. In addition to its committed bank facilities of Swedish krona (SEK) 3.5 billion (\$385 million), Malmö holds untapped checking accounts totaling SEK1 billion, which complement a cash balance structurally positioned at about SEK700 million. The city has also signed a loan agreement with the European Investment Bank and we include SEK1.3 billion of this amount as a liquidity source. Moreover, the city has opted to focus on long-term bond issuance as a source for funding its growing loan portfolio, which will lead to an increasingly predictable maturity profile.

KEY STATISTICS

Table 1

City of Malmö Key Statistics

| (Mil. SEK) | --Fiscal year end Dec. 31-- | | | | | |
|--|-----------------------------|--------|--------|--------|--------|--------|
| | 2014 | 2015 | 2016 | 2017bc | 2018bc | 2019bc |
| Operating revenues | 19,247 | 20,482 | 21,988 | 23,178 | 23,860 | 24,653 |
| Operating expenditures | 18,458 | 19,245 | 20,280 | 21,384 | 22,451 | 23,188 |
| Operating balance | 789 | 1,237 | 1,708 | 1,794 | 1,409 | 1,465 |
| Operating balance (% of operating revenues) | 4.1 | 6.0 | 7.8 | 7.7 | 5.9 | 5.9 |
| Capital revenues | 73 | 424 | 400 | 308 | 355 | 293 |
| Capital expenditures | 2,301 | 1,961 | 2,280 | 2,477 | 2,502 | 2,440 |
| Balance after capital accounts | (1,439) | (300) | (172) | (375) | (738) | (682) |
| Balance after capital accounts (% of total revenues) | (7.4) | (1.4) | (0.8) | (1.6) | (3.0) | (2.7) |

Table 1

City of Malmo Key Statistics (cont.)

| (Mil. SEK) | --Fiscal year end Dec. 31-- | | | | | |
|---|-----------------------------|---------|---------|---------|---------|---------|
| | 2014 | 2015 | 2016 | 2017bc | 2018bc | 2019bc |
| Debt repaid | 1,750 | 2,148 | 1,862 | 3,963 | 4,350 | 4,500 |
| Gross borrowings | 4,767 | 3,904 | 2,648 | 5,366 | 6,914 | 6,823 |
| Balance after borrowings | 484 | 66 | (529) | 11 | 0 | 0 |
| Modifiable revenues (% of operating revenues) | 60.3 | 60.2 | 59.5 | 59.5 | 59.7 | 59.9 |
| Capital expenditures (% of total expenditures) | 11.1 | 9.2 | 10.1 | 10.4 | 10.0 | 9.5 |
| Direct debt (outstanding at year-end) | 7,805 | 9,561 | 10,347 | 11,750 | 14,314 | 16,637 |
| Direct debt (% of operating revenues) | 40.6 | 46.7 | 47.1 | 50.7 | 60.0 | 67.5 |
| Tax-supported debt (outstanding at year-end) | 8,606 | 9,856 | 10,724 | 12,128 | 14,692 | 17,015 |
| Tax-supported debt (% of consolidated operating revenues) | 38.6 | 41.5 | 42.6 | 45.7 | 53.6 | 60.0 |
| Interest (% of operating revenues) | 0.6 | 0.6 | 0.4 | 0.5 | 1.5 | 2.2 |
| Local GDP per capita (SEK) | N/A | N/A | N/A | N/A | N/A | N/A |
| National GDP per capita (SEK) | 408,180 | 428,947 | 444,480 | 458,978 | 473,472 | 486,988 |

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

City of Malmo Ratings Score Snapshot

| Key rating factors* | |
|-------------------------|--------------------------------------|
| Institutional framework | Extremely predictable and supportive |
| Economy | Very strong |
| Financial management | Very strong |
| Budgetary flexibility | Average |
| Budgetary performance | Strong |
| Liquidity | Exceptional |
| Debt burden | Low |
| Contingent liabilities | Low |

*Our 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" summarizes how the eight factors are combined to derive the foreign currency rating on an LRG.

KEY SOVEREIGN STATISTICS

Sovereign Risk Indicators, April 10, 2017. An interactive version is also available at <http://www.spratratings.com/sri>.

RELATED CRITERIA AND RESEARCH

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - June 01, 2016
- 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

- 2016 Annual Non-U.S. Local And Regional Government Default Study And Rating Transitions - May 08, 2017
- Sovereign Risk Indicators - April 10, 2017. An interactive version is also available at <http://www.spratratings.com/sri>
- Swedish Local And Regional Government Risk Indicators: April 2017 Update - April 05, 2017
- Widespread Investment Is Pushing Up Nordic Local And Regional Government Borrowing - February 20, 2017
- Sweden's New Equalization System Will Hurt Some LRGs' Finances But Not Their Credit Quality - February 09, 2015

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.

Swedish City of Malmo Ratings Affirmed At 'AAA/A-1+' And 'K-1'; Outlook Stable

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 |
| Malmo (City of) | | |
| Issuer Credit Rating | | |
| Foreign and Local Currency | AAA/Stable/A-1+ | AAA/Stable/A-1+ |
| Nordic Regional Scale | --/--/K-1 | --/--/K-1 |
| Senior Unsecured | | |
| Foreign and Local Currency | AAA | AAA |
| Short-Term Debt | | |
| Foreign and Local Currency | 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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at 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.

Additional Contact:

International Public Finance Ratings Europe; PublicFinanceEurope@spglobal.com

Copyright © 2018 Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.