S&P Global
Ratings

Research

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

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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 flexibilites 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. Malmo 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 onlending is centered around Malmo'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 onlending 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 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 Malmo 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 Malmo Key Statistics

	--Fiscal year end Dec. 31--					
(Mil. SEK)	**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.)

	--Fiscal year end Dec. 31--					
(Mil. SEK)	**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.spratings.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.spratings.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.

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.

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