

### CREDIT OPINION

12 December 2019

✓ Rate this Research

#### RATINGS

##### Municipal Guarantee Board

Domicile	Finland
Long Term Rating	Aa1
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Municipal Guarantee Board (Finland)

### Update to credit analysis

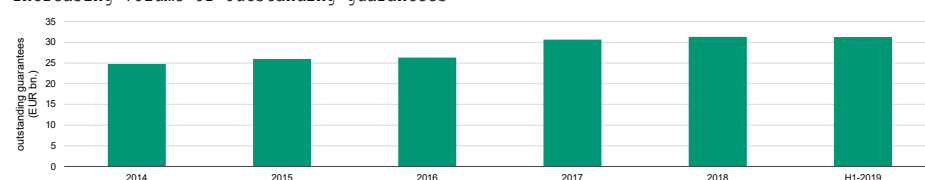
#### Summary

The credit profile of the [Municipal Guarantee Board](#) (MGB, Aa1 stable) reflects the strong cooperation and links between the [Government of Finland](#) (Aa1 stable) and MGB's member municipalities. The interlinks, controls and importance of services provided by the local government sector indicate that the ultimate support provider in the unlikely event of an acute liquidity stress would be the Government of Finland.

MGB was set up by the Finnish parliament in 1996 under a special law with the purpose of safeguarding and developing the joint funding of Finnish municipalities. MGB plays its role by guaranteeing all funding by credit institutions directly or indirectly owned by municipalities that will be used for lending to municipalities, entities under their control and government guaranteed social housing entities. These guarantees improve funding availability and assist the municipalities ability to deliver their public services in Finland as mandated by the central government. [Municipality Finance Plc](#) (MuniFin, Aa1 stable) is the only entity benefiting from MGB's guarantees.

Exhibit 1

#### Increasing volume of outstanding guarantees



Source: MGB

#### Credit strengths

- » Strong ties between the municipality sector and the central government
- » Joint guarantee issued by all municipalities on the Finnish mainland
- » Important role played by MGB plays in the Finnish local government funding system
- » Low likelihood of guarantee being triggered

#### Credit challenges

- » Weak standalone liquidity in relation to total guarantee stock
- » Untested guarantee mechanism

## Rating outlook

The rating outlook is stable. This reflects the outlook of its support provider, the Government of Finland.

## Factors that could lead to an upgrade

An upgrade in Finland's sovereign rating could lead to an upgrade of MGB's rating.

## Factors that could lead to a downgrade

Negative pressure on the rating could result from one or a combination of the following: (1) a downgrade of Finland's sovereign rating, (2) a weakening of the ties between the local government sector and the sovereign, (3) a weakening of the MGB Act and the joint guarantee, or (4) a reduced importance of MGB.

## Detailed credit considerations

The credit profile of MGB, as expressed in an Aa1 stable issuer rating reflects the support from the central government. In our view, it is not significant to distinguish between MGB and Government of Finland. The significance of MGB's public mandate and the members' close ties with the central government leads to an expectation of ultimate support from the central government to provide liquidity in the unlikely event that the local government sector and MGB would require this support.

## Strong ties between the municipality sector and the central government

While the Finnish municipality sector is characterized by a high level of devolved powers, there are also strong ties and dialogue between the local government and the central government. Local authorities have full autonomy to levy municipal income tax and property tax. By law, municipalities have an obligation to balance their finances over a four-year period. The Finnish municipality sector is present at the highest level of parliament debates via the Finnish Local and Regional Authority, collaborating on all matters affecting their own sector. Local finances and services are assessed every year and should a municipality be flagged, the municipal council would immediately start a recovery plan to address any highlighted issues. The creditworthiness of the municipality sector stems from a high level of revenue predictability, modest, although increasing, levels of debt, a strong equalization system and, most importantly, the close government oversight, collaboration and ties. Around one-fourth of the local government's revenue in Finland comes from the central government via central government transfers.

The ongoing reform of health and social care (SOTE) will most probably impact the setup and tasks of local governments. This reform has been in political discussion for a while yet. In early 2019, [the constitutional law committee said that the reform must be changed substantially to meet requirements, which lead to a government resignation](#). With a recently elected new government in office, we understand that an amended reform proposal will be presented and implementation could take place from 2023 potentially. As a result of the reform, 18 new counties (covering area of several municipalities) would take over health care tasks from municipalities, which would imply an amendment of the current structure of funding, including taxation rights and government transfers. We will monitor development around the Finnish health care reform and its potential impact on MGB's credit profile.

## Joint guarantee issued by all municipalities on the Finnish mainland

In accordance with the MGB Act, MGB guarantees are strong because all municipalities located on the Finnish mainland are members. Consequently, MGB guarantees are backed by the entire nations' municipal tax base. If one municipality fails to meet its obligations to MGB, then all peers are required to cover the shortfall on a joint basis based on population size. The island of Åland, which represents 0.5% percent of the Finnish population, is not an MGB member because of its self-governance status. The payment obligation can be used without a court order and the MGB Act allows MGB to support government-owned credit institutions even before the latter fails to make a payment to its creditors. Since MGB's inception, the only credit institution to meet the criteria set out in the Act was Municipality Finance Plc. Therefore, MGB is likely to support MuniFin without going through complex procedures.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moodys.com](http://www.moodys.com) for the most updated credit rating action information and rating history.

### **MGB plays an important role in the Finnish local government funding system**

MGB was established by law in 1996. The MGB Act allows it to extend guarantees to any credit institution that is (a) owned or controlled by municipalities; and (b) in the business of lending to municipalities and their associated entities, and government guaranteed social housing companies. MGB, however, only guarantees MuniFin's debt (and payments from hedging counterparties to MuniFin) because MuniFin is the only credit institution owned by municipalities in Finland. In effect, MGB ensures that MuniFin meets its obligations and allows it to function as the debt management office for the Finnish local government sector.

Funds borrowed from MuniFin are used for investments in public services such as education, social housing and elderly care. The municipalities are in continuous dialogue with the central government about the legislation concerning the services to be provided by the municipal sector.

The strong ties between MGB and the central government are also underlined by its governance. The Ministry of the Finance appoints MGB's council of 15 members at the recommendation of the Association of Finnish Local and Regional Authorities. Members serve four-year terms. The council appoints a board of seven members and the board in turn appoints the managing director for MGB. MGB has its own auditor as well as one appointed by the Ministry of Finance.

### **Low likelihood of guarantee being triggered**

MuniFin's underlying credit strengths makes the likelihood of MGB needing to action the guarantee very remote. MuniFin has a history of strong predictable financial performance, an important national and public mandate, diverse funding resources and a low risk appetite. In addition, MuniFin's liquidity is of good quality and large in size. As of year-end 2018, the liquidity portfolio (mainly consisting of debt securities, cash and balances with central banks) amounted to €9.4 billion compared with total assets of €35.7 billion. MuniFin also benefits from Central Bank access. Thus, MGB will only be required to exercise the guarantee in the remote and unlikely chance that MuniFin faces acute financial distress and a long-term loss of access to wholesale funding.

### **Weak standalone liquidity in relation to total guarantee stock**

MGB's has a standalone liquidity portfolio of €17.7 million and also benefits from a recently increased committed credit line (€ 200 million). This is considered small compared with its outstanding guarantee stock, which as of mid-2019 amounted to € 31.3 billion. From a credit perspective, MGB's liquidity profile is one element but moreover we take also comfort from the sizable reserves held by MuniFin and the Finnish local government sector's financial strength. The Finnish local government sector holds around €6 billion in cash reserves (as of 31 December 2018), which MGB members could use to support MGB. Projections from the Ministry suggest that the level of liquidity will remain stable during the next four years.

### **Untested guarantee mechanism**

The MGB guarantee has never been triggered, but practical procedures for delivering financial support to MuniFin has been documented. MGB can claim payment from its member-municipalities to support MuniFin without a court order.

A mitigating factor is the financial health of Finnish local government sector<sup>1</sup>. MuniFin and MGB could take several early-steps to prevent triggering the MGB-guarantee mechanism. This view is based on the fact that:

1. MuniFin maintains liquid securities sufficient to cover obligations for a minimum of six months, assuming uninterrupted lending. MuniFin can also repo its municipal lending portfolio with the central bank.
2. The Finnish local government sector holds around €6 billion in cash reserves.
3. MGB has access to a €200 million liquidity line with one counterparty and maintains its own small (€17.7 million) investment portfolio.

## ESG Considerations

### How environmental, social and governance risks inform our credit analysis of MGB

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of MGB, we assess the materiality of ESG to the credit profile as follows:

Environmental risks are not material for MGB's rating. MGB's members (local governments) are exposed to environmental risks, including severe weather conditions or rising sea levels, could have an impact. Nevertheless, these risks are not material for the rating of MGB.

Social risks are not material for MGB. However, MGB's members are exposed to the challenges of providing services to an aging population with higher dependency ratios. Over time, these challenges can add pressure on municipalities' finances, even though central government plays a significant role in mitigating some of those pressures as well as the fact that the sector's institution framework is established to mitigate some of those pressures. Overall, we consider the issuer to have a moderate exposure to social risk, in line with the Finnish municipal governments.

Governance risk is material for MGB, as it has to abide by the mandate set by the law. It is also subject to close oversight by the central government.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

### Rating methodology

We use the [Government-Related Issuers](#) rating methodology, published in June 2018.

The significance of the joint and pro-rata guarantee, involving all Finnish municipalities, ultimately leads to an expectation of support from the Government of Finland in the unlikely event of financial distress.

## Ratings

Exhibit 2

Category	Moody's Rating
<b>MUNICIPAL GUARANTEE BOARD</b>	
Outlook	Stable
Issuer Rating -Dom Curr	Aa1

Source: Moody's Investors Service

## Endnotes

<sup>1</sup> [Moody's: Nordic Local Governments' Credit Quality Boosted by Support Expectation and Inherent Strength, published on 20 May 2016](#)

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