MOODY'S INVESTORS SERVICE

CREDIT OPINION
19 December 2023

Update

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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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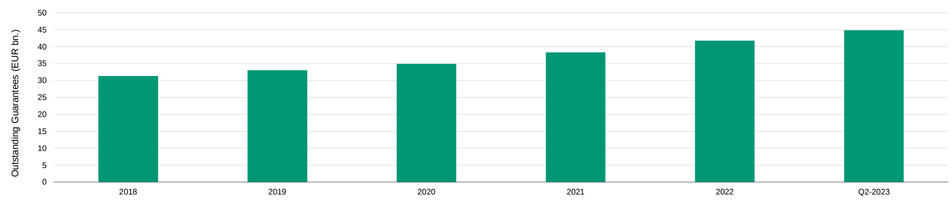
Municipal Guarantee Board (Finland)

Update following rating affirmation

Summary

The credit profile of the Municipal Guarantee Board (MGB, Aa1 stable) reflects the strong linkages between the Government of Finland (Aa1 stable) and MGB's member municipalities. The importance of services provided by the local government sector indicates that the ultimate support provider in the unlikely event of an acute liquidity stress would be the Government of Finland. MGB can grant guarantees for funding by public sector credit institutions that will be used for lending to municipalities, municipal entities and guaranteed social housing entities. Municipality Finance Plc (MuniFin, Aa1 stable) is the only entity benefiting from MGB's guarantees.

Exhibit 1
Increasing volume of outstanding guarantees



Q2-2023: Guarantees in use as of 30.06.2023
Source: MGB, Moody's Investors Service

Credit strengths

» Municipal sector closely linked to the central government

» All mainland municipalities in Finland jointly provide a guarantee for MGB

» MGB's special public policy role in the Finnish local government funding system

» The governance structure incorporates both central and local governments, underscoring a commitment to low risk acceptance

» MuniFin's asset quality is a strong element in assessing MGB's risk

» Robust risk management framework and multiple liquidity tiers before MGB call

Credit challenges

» Relatively limited stand-alone liquidity mitigated by strong municipalities' cash reserves

» Untested guarantee mechanism

Rating outlook

The stable outlook mirrors the stable outlook of its support provider, the Government of Finland. The stable outlook on the Municipal Guarantee Board reflects the stability of the guarantee mechanism that will continue to operate without any significant changes. Furthermore it factors in the MGB' robust financial risk profile and the high credit quality of the municipal sector including that of the newly established wellbeing counties. At the same time, the stable outlook reflects MGB's substantial public policy mandate which will persist without any modifications in the foreseeable future.

Factors that could lead to an upgrade

An upgrade of 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 weakening of MGB public policy mandate and its importance for lower-tier governments.

Detailed credit considerations

On 15 December 2023, Moody's affirmed MGB's credit ratings of Aa1 with stable outlook.

Finland's Health and Social Services Reform, effective from 1 January 2023, transfers the responsibility of social and healthcare services from 293 municipalities to newly established 21 wellbeing services counties. This decreases municipalities' financial burdens and credit needs, reducing the demand for Municipal Guarantee Board (MGB) guarantees. However, new counties may need to borrow funds for their operations, potentially increasing the demand for MGB guarantees. Legislative changes permit MGB and MuniFin to finance existing and new loans for the new counties. The claims of these new counties and joint county authorities will be treated similarly to central government exposures, thus receiving a 0% risk weight as interpreted by the Financial Supervisory Authority (FIN-FSA), suggesting they could be accepted as MGB group members and have access to all MuniFin services. Around €4 billion of MGB-backed debt financed by MuniFin will be transferred to new authorities. We will continue monitoring the potential impact of the reform on MGB's credit profile.

The credit profile of MGB, as expressed in its Aa1 issuer rating reflects the support from the central government and in our view, it is not significant to distinguish between MGB and Government of Finland. MGB's credit strength is inextricably linked with that of the Government of Finland because of its status as public policy entity and MGB's mandate to safeguard and develop joint funding for Finnish municipalities.

Baseline credit assessment

Municipal sector closely linked to the central government

The Finnish local government sector's high credit quality is attributed to a robust, decentralized municipal sector and stringent oversight by the Ministry of Finance. The sector's robustness is enhanced by a strong institutional framework, including a legal mandate for balanced budgets over a four-year span, a history of intervention in instances of service failure and financial distress, a well-established equalization system, and reliable market access through MuniFin.

Local authorities have complete control over municipal income and property taxes. The Association of Finnish Local and Regional Authorities represents municipalities in parliamentary debates. If a municipality is distressed, a recovery plan is promptly initiated by the municipal council. The sector's creditworthiness is derived from a predictable revenue, moderate yet rising debt, and close linkages between central and local governments. Local governments' revenue is made up of their own tax revenue (55%), central government transfers (25%), and non-tax operating income. Finland's competitive economy and strong institutional framework support the sector's credit fundamentals. Central government support, evident during the pandemic, further mitigates potential risks.

In 2022, the financial support from the central government to municipalities to counteract the impact of the pandemic was €0.8 billion, a decrease from the €2.4 billion in 2021 and €2.5 billion in 2020. Despite this, a 5.5% increase in tax revenue allowed the local government sector to report a positive outcome of €1.3 billion at the end of 2022, although this was lower than the €1.6 billion in 2021 and €1.7 billion in 2020. We expect that Finland's real GDP growth will increase by 0.9% in 2023, following a forecasted contraction of 0.7% in 2023. This is expected to result in a slight increase in income tax proceeds, which are the primary source of revenue for Finnish local governments, and should balance out the anticipated discontinuation of COVID-19 grants from 2023. This growth in tax revenue should also offset the anticipated increases in costs due to wage increases and a reform of wage payments in the municipal sector. The rising costs for education due to falling birth rate and smaller age groups could potentially cause a slight decline in the municipalities' operating balances forecasted over the same period. Furthermore, there is significant uncertainty surrounding the reform of health and social care.

From 2022 onwards, the outstanding debt of the municipalities is expected to decline as the healthcare and wellbeing social services will be transferred to new services counties and all the associated debt to these services will be gone from the balance sheet of the municipalities. The debt outstanding of €24.7 billion at year-end 2022 should decline to €19 before it slightly increase to €19.9 billion in 2023 and 2024, respectively.

All mainland municipalities in Finland jointly provide a guarantee for MGB

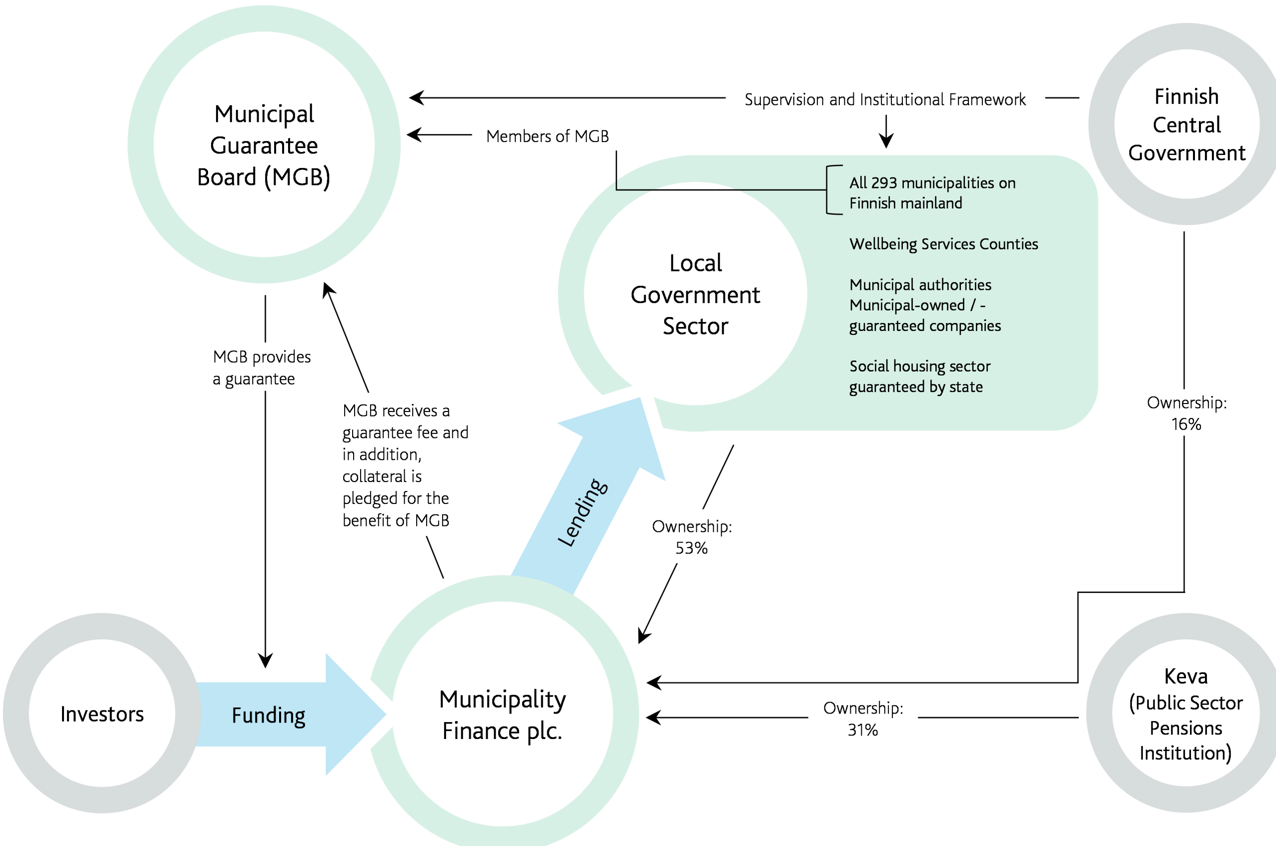
The creditworthiness of the MGB is underpinned by the backing of Finland's strong local government sector, as all member municipalities, which represent nearly the entire Finnish population (excluding the Åland Islands), provide a joint guarantee. Therefore, the guarantees offered by the MGB are supported by the national municipal tax base. In the event that MuniFin is unable to meet its obligations, the guarantor MGB in the first place and then MGB member municipalities are collectively responsible for MGB's obligations in proportion to their population, as stipulated in Section 10 of the MGB Act. The Åland Islands, accounting for 0.5% of Finland's population and having a status of self-governance, are not part of the MGB.

The payment obligation can be used without 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.

MGB's special public policy role and status in the Finnish local government funding system

MGB was established by law in 1996 aiming to complement the credit institution activities serving the local government sector. The legislation highlights its special public policy role, function as a safeguard and development of the joint funding for municipalities. 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.

Exhibit 2
Finnish Joint Funding System



Source: MGB, Moody's Investors Service

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 governance structure incorporates both central and local governments, underscoring a commitment to low risk acceptance

The governance structure of MGB emphasizes its close linkages with the central government. The Ministry of Finance, based on recommendations from the Association of Finnish Local and Regional Authorities, appoints a 15-member council for MGB, with each member serving a term of four years. This council then selects a seven-member board, which is responsible for appointing MGB's managing director. Both an independent auditor and one appointed by the Ministry of Finance oversee MGB's audits.

Legally, MGB is required to manage its surplus liquidity with a focus on safety, yield, and liquidity. MGB allocates 50% (+/-10%) of its investments to plain vanilla investment grade debt instruments issued by governments, banks, companies or investment funds and 50% (+/-10%) to investment funds and shares of companies listed on the Helsinki Stock Exchange. Maximum of 10 per cent of the investment portfolio can be allocated in alternative investments.

MuniFin's asset quality is a strong element in assessing MGB's risk

The Finnish local government sector is regarded as one of the most sound in Europe. MuniFin's asset quality remains very strong and its lending is restricted to the following types of borrowers (with share of lending as of December 2022):

» Local Governments (32% of the total loan portfolio)

- Local Government Corporations – entities' loans guaranteed by local governments that are members of MGB (10% of the total loan portfolio),
- Joint Municipal Authorities (11% of the total loan portfolio),
- Social Housing Corporations - loans guaranteed by the Finnish Government (47% of the total loan portfolio)

MuniFin is jointly owned by the Finnish local governments (53%), the Finnish public sector fund Keva (31%) and the Government of Finland (16%). All local governments and their guarantees are weighted at zero risk by FSA-FIN.

MuniFin's underlying credit strengths makes the likelihood of MGB needing to action the guarantee very remote. MuniFin has a history of a strong and predictable financial performance, an important national and public mandate, diverse funding resources and a low risk appetite. Thus, MGB will only be required to exercise the guarantee in the remote and unlikely event that MuniFin faces acute financial distress and a long-term loss of access to wholesale funding.

Robust risk management structure and multiple liquidity tiers before MGB call

Were MuniFin to encounter any difficulty in meeting its obligations, the MuniFin investor or a derivative counterparty can immediately claim payments from MGB. Claims by the MGB to its members for contributions for their share of contributions to satisfy any calls on the guarantee of the MGB can be collected without a court order.

If the MGB member were to unable to pay its share of such call, other members would be jointly liable in proportion for this shortfall as well, in proportion to their respective population. In addition to providing security by demand for bondholders, MGB has the discretion under the MGB Act to provide funds to MuniFin as needed, in advance of a distress scenario crystallising.

MGB has put in place several layers of protection, before needing to call additional capital under the guarantee. MGB has its own liquidity in the form of securities and liquid funds, which totaled €26.9 billion in Q2 2023, together with a committed credit line of €200 million with Nordic Investment Bank. These liquidity sources serve as a first line of defense, allowing for the injection of capital into Municipality Finance in the unlikely event that it faces financial difficulty. As a second line of defense, MGB may be able to obtain additional funds from its members if its own liquidity sources are insufficient.

Relatively limited stand-alone liquidity mitigated by strong municipalities' cash reserves

We consider MGB's liquidity as low compared with its outstanding guarantee stock, which at year-end 2022 amounted to €41.8 billion. From a credit perspective, MGB's liquidity profile is limited but moreover, we take comfort from the sizable reserves held by MuniFin and the Finnish local government sector's financial strength.

The Finnish local government sector holds €8.8 billion in cash reserves (as of 31 December 2022) up from €8.1 billion a year before, representing strong 23.3% of sector operating revenue. Municipalities could use its cash reserves to support MGB in unlikely event of need. Projections from the Ministry of Finance suggest that the level of local government sector's liquidity will remain between €8.8 billion and €9.2 billion over 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, which despite the coronavirus pandemic, maintained its strength thanks to comprehensive financial support packages from the central government between 2020 and 2022. In addition, MuniFin and MGB could take several early steps to prevent triggering the MGB guarantee mechanism.

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, the materiality of ESG to the credit profile is largely based on the ESG considerations for the Government of Finland or respectively its local government sector entities (i.e. MGB's members), along with specific considerations:

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 ageing 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 local governments.

Governance risk is material for MGB, as it has to abide by the mandate set by the law. The governance framework is intrinsically intertwined with the supporting government, which exerts oversight through the Ministry of Finance and influences the definition of MGB strategy through the MGB Council.

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 February 2020.

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 3

Category	Moody's Rating
MUNICIPAL GUARANTEE BOARD	
Outlook	Stable
Issuer Rating -Dom Curr	Aa1
MUNICIPALITY FINANCE PLC	
Outlook	Stable
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Issuer Rating	Aa1
Bkd Senior Unsecured	Aa1
Bkd Commercial Paper -Dom Curr	P-1
Bkd Other Short Term -Dom Curr	(P)P-1

Source: Moody's Investors Service

Moody's related publications

» Municipality Finance Plc : Update to credit analysis, May 2023

» Government of Finland – Aa1 stable: Regular update, December 2023

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