

## CREDIT OPINION

4 December 2020

✓ 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

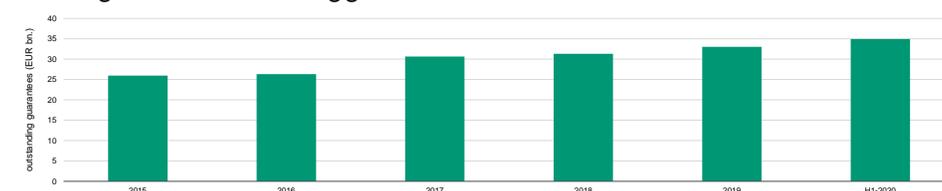
### Summary

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 (MGB Act) with the purpose of safeguarding and developing the joint funding of Finnish municipalities. MGB guarantees all funding by public sector credit institutions that will be used for lending to municipalities, municipal entities 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 weakening of MGB public policy mandate and its importance for lower-tier governments.

## 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.

A planned reform of health and social care (so called SOTE) will impact the setup and tasks of local governments. The new government proposed and amended reform plan in October 2020, which will be submitted to Parliament in early December. We understand that this is an important step forward, after the [previous government's proposal failed in front of the constitutional court](#) in early 2019. We understand that implementation of the current reform proposal is aimed from 2023 onwards and includes setting up 21 counties. The counties geographically comprise the area of several local governments and take over responsibilities for health care, currently operated by local governments. As part of the implementation, it is planned to amend funding and taxation rights of current local governments as well as to give rights to established counties. We will monitor development around the Finnish health care reform and its potential impact on MGB's credit profile. We understand that the new setup would require amendments to the MGB Act.

The coronavirus (COVID-19) outbreak resulted in a decline of global economic output and [uncertainties around future recovery](#), which will continue to determine Finnish economic growth and related tax revenue development. We expect that Finland's economic output will contract by 5% in 2020 and recover 2.7% in 2021. This is affecting tax revenues of local governments negatively, however, central government has taken steps to mitigate the impact by granting additional transfers to local governments.

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.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

### 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.

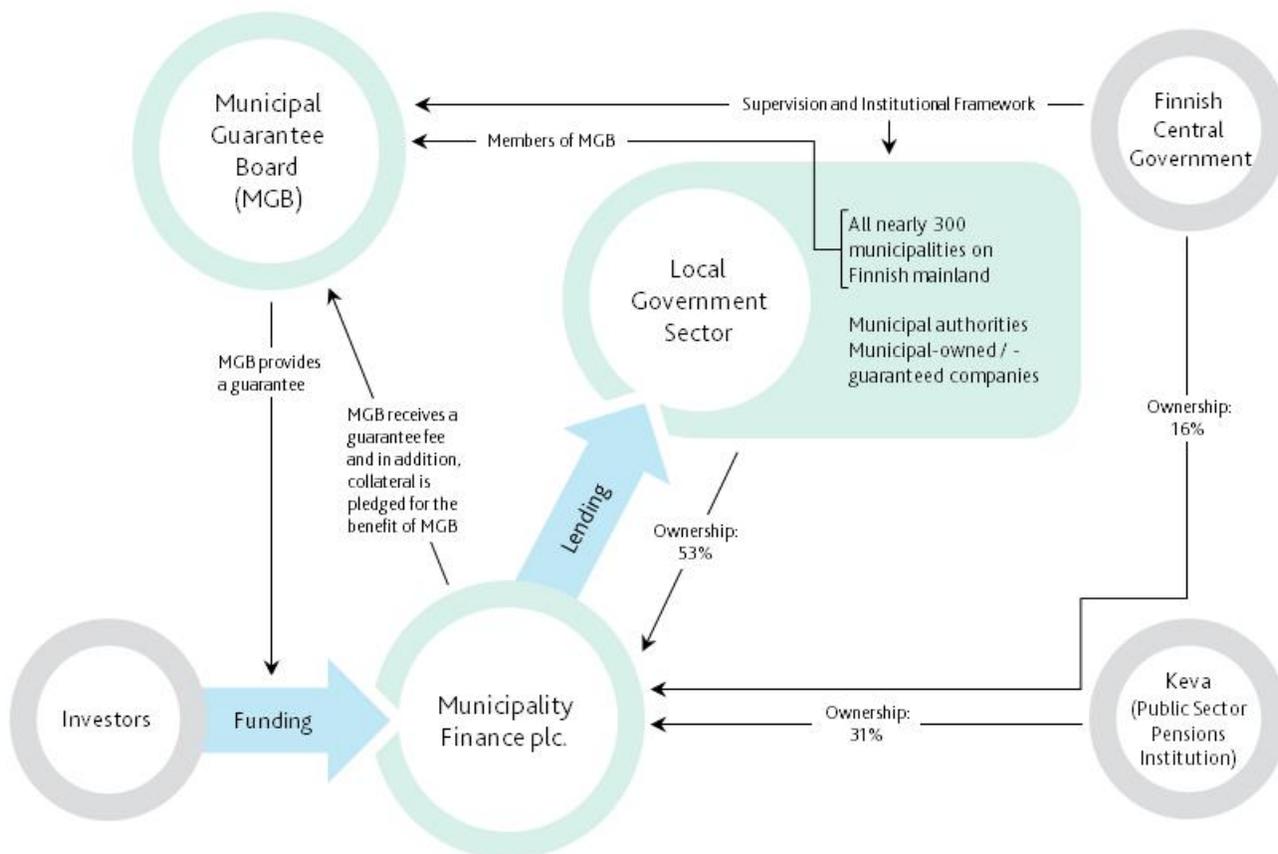
Under the SOTE reform, together with responsibilities and operations, around €2 billion of debt would be transferred to new counties from municipalities. The government proposed to amend the MGB Act to allow MGB and MuniFin to provide funding to new counties.

### 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.

Exhibit 2

#### Finnish Joint Funding System



Source: 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 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

Despite pressure on local governments' budgets due to the coronavirus outbreak, 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 June 2020, the liquidity portfolio (mainly consisting of debt securities, cash and balances with central banks) amounted to €8.3 billion compared with total assets of €40.2 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

As of June 2020, MGB's has a standalone liquidity portfolio of €19.8 million and also benefits from a committed revolving credit facility (€200 million). This is considered small compared with its outstanding guarantee stock, which as of mid-2020 amounting to €34.9 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 €6.3 billion in cash reserves (as of 31 December 2019), which MGB members could use to support MGB. Projections from the Ministry of Finance suggest that the level of local government sector's liquidity will increase 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, which despite the coronavirus outbreak, should be maintained thanks to comprehensive financial support packages over 2020 and 2021.<sup>1</sup> In addition, 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 (€19.8 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 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. We view the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety, and municipalities' tax base. 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 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
<b>MUNICIPAL GUARANTEE BOARD</b>	
Outlook	Stable
Issuer Rating - Dom Curr	Aa1

Source: Moody's Investors Service

## Moody's related publications

- » [Global Macro Outlook 2021-22 : Nascent economic rebound takes hold globally but recovery will remain fragile](#), November 2020
- » [Municipality Finance Plc : Update following ratings affirmation](#), September 2020
- » [Government of Finland – Aa1 stable: Annual credit analysis](#), July 2020
- » [Government of Finland – Aa1 stable: Update following rating affirmation, outlook unchanged](#), July 2020
- » [Regional & Local Governments – Sweden : Government financial support mitigates coronavirus effects](#), May 2020

## Endnotes

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

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