

CREDIT OPINION

19 December 2024

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)

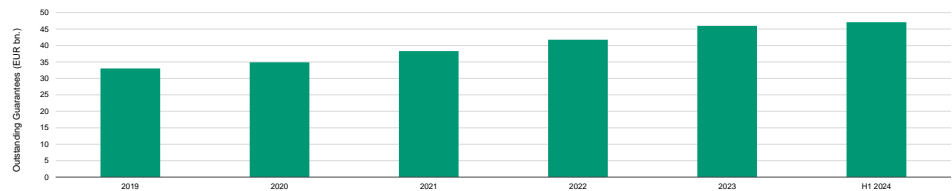
Update to credit analysis

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, wellbeing services counties 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



H1 2024: Guarantees in use as of 30 June 2024

Source: MGB, Moody's Ratings

Credit strengths

- » Integrated governance and special public policy role
- » Collective guarantee system
- » MuniFin's asset quality and robust risk management
- » Commitment to financial stability

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 the Government of Finland. The stable outlook reflects the stability of the guarantee mechanism that will continue to operate without any 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 services counties. The stable outlook also reflects MGB's 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.

Key indicators

Detailed credit considerations

Finland's Health and Social Services Reform (SOTE), 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 €5 billion of MGB-backed debt financed by MuniFin were transferred to new authorities. In November 2023, the MGB Council decided to allocate €900 million for the liquidity needs of the wellbeing services counties and €400 million for new investments for the year 2024. 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

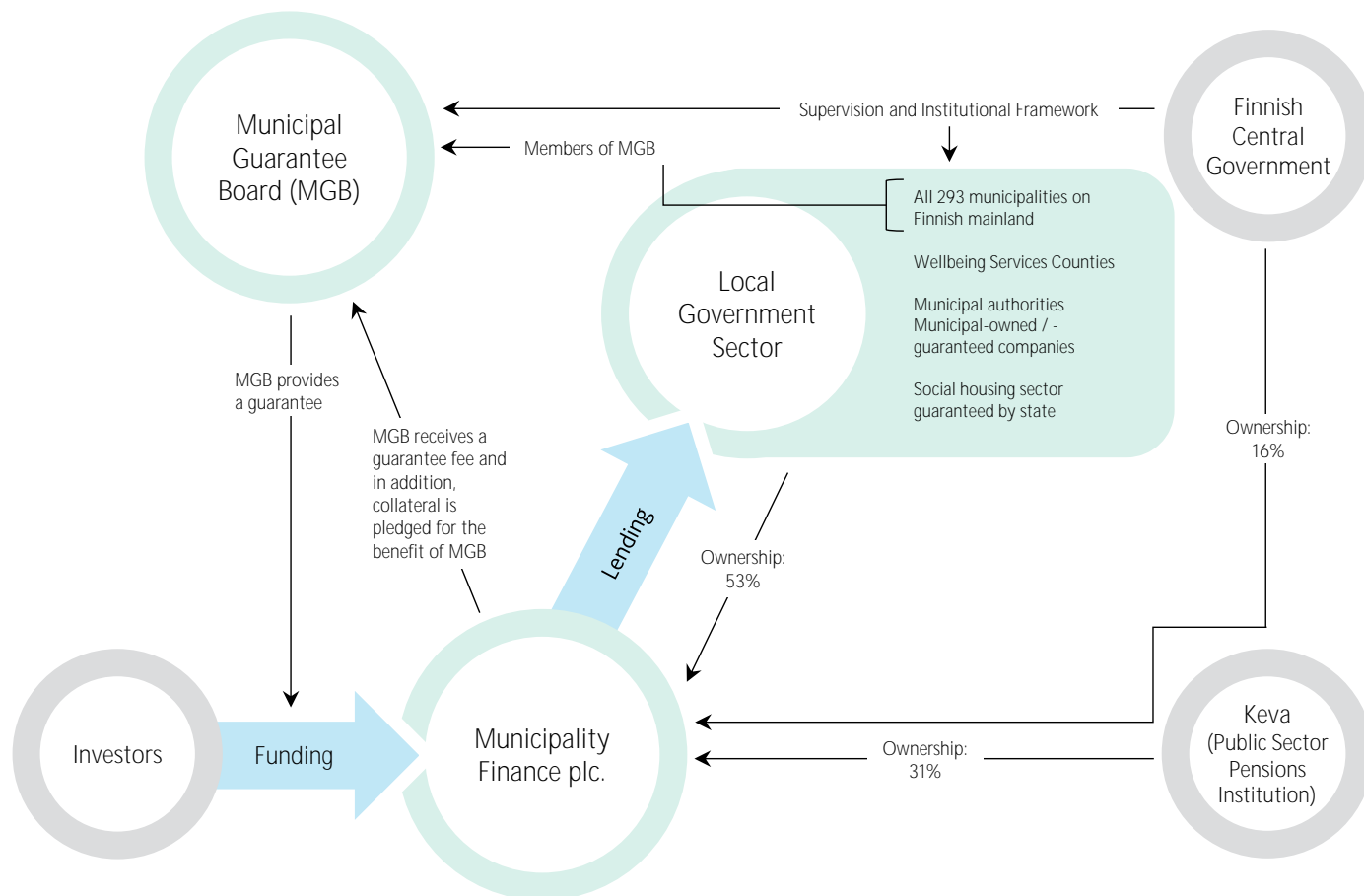
Integrated governance and special public policy role

The governance structure's integration of both central and local government levels underscores a commitment to low risk acceptance, closely linking the municipal sector to the central government. This integration is further reinforced by MGB's special public policy role in the Finnish local government funding system, highlighting a strong relationship that enhances its stability and reliability.

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.

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Exhibit 2
Finnish Joint Funding System



Source: MGB, Moody's Ratings

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.

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.

The sector's creditworthiness is derived from a predictable revenue, manageable and stable debt levels, and close linkages between central and local governments. Municipal revenues are made up of own tax revenues (60%), central government transfers (15%), and the remainder consisted of non-tax operating revenues. Local governments' financial performance improved in 2023 with operating balance of €4.2 billion from €3.5 billion in 2022 and net financial result of €1.7 billion compared with €1.2 billion over the same period. In 2024, the operating margin is projected to weaken by around €1 billion as the exceptional tax funding items related to the health and social services reform are removed and the economic contraction of 0.5% forecasted for this year will negatively impact the proceeds from tax revenues.

Municipalities' operating performance is expected to weaken further in 2025 due to rising costs, investment pressures, and adjustments related to state subsidies from the SOTE reform. The cost increase is primarily driven by the wage increases and an employment and

business services reform whose funding will be allocated to municipalities through state grants for basic public services. This reform will expand municipal responsibilities and increase operating costs by nearly €900 million in 2025. The rising costs for education due to falling birth rate and smaller age groups could also contribute to declining municipalities' operating balances forecasted in 2025.

The outstanding municipalities' debt amounted €18.8 billion at year-end 2023 representing around 80% of sector operating revenue. When adding the loan stock of joint municipal authorities, the total outstanding debt was €19.9 billion, which is almost €5 billion less comparing with 2022 debt levels. The debt decline was driven by SOTE reform and corresponding removal of hospital districts and special care districts' loans from the balance sheets of joint municipal authorities. However, the municipalities and joint municipal authorities' debt levels are expected to grow steadily, with the total loan stock estimated to increase to €27.9 billion by 2028 as the investment needs remain high due to aging infrastructure, population movements, and the green transition.

Collective guarantee system

All 293 mainland municipalities in Finland provide a joint guarantee for MGB, establishing a robust collective backing that significantly enhances MGB's creditworthiness. The MGB Act does not allow member municipalities to withdraw from MGB. This system of mutual guarantees not only underscores the cooperative spirit among Finnish municipalities but also significantly reduces the risk for lenders and investors, as it distributes potential financial burdens across a broad base.

MGB's member municipalities represent nearly the entire Finnish population (excluding the Åland Islands) meaning that 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 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.

MuniFin's asset quality and robust risk management

MuniFin's asset quality stands out as a critical component of MGB's risk assessment framework. This strength, combined with a robust risk management framework and a structured approach to liquidity that includes multiple tiers before an MGB call is necessary, forms a comprehensive strategy for maintaining financial stability and integrity. This approach ensures that risks are effectively mitigated through proactive measures.

MuniFin's importance to the Finnish local government sector and affordable social housing sectors is also reflected by its leading market share. MuniFin's dominant position is underpinned by its not-for-profit mandate and is likely to persist since its public-policy mandate is to lend at cost-effective rates rather than maximising profit.

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 June 2024):

- » Municipalities (29% of total loan portfolio)
- » Local Government Corporations – entities' loans guaranteed by local governments that are members of MGB (11% of total loan portfolio),
- » Wellbeing Services Counties (10% of total loan portfolio)
- » Joint Municipal Authorities (1% of the total loan portfolio),
- » Social Housing Corporations - loans guaranteed by the Finnish Government (49% of the total loan portfolio)

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

MGB's risk management focuses on safeguarding the joint funding of municipalities, with a robust framework for monitoring and managing financial risks. MGB maintained a guarantee stock of nearly €46 billion at year-end 2023 and its guarantees for MuniFin's long-term funding are forecasted to increase, with a projected maximum amount of €48 billion for 2025.

On the other hand, MuniFin's risk management operations adhere to prudent principles, ensuring compliance with regulatory requirements. Its 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.

Commitment to financial stability

The elements of strong asset quality, an integrated risk management framework, and a multi-tier liquidity strategy, together with the collective guarantee provided by all mainland municipalities, reflect a deep-seated commitment to maintaining financial stability. This commitment is crucial for safeguarding the interests of stakeholders and ensuring the long-term sustainability of the Finnish local government funding system.

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 be 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 invests in liquid instruments, with a balanced allocation between fixed-income and equity investments. The fund is expected to grow, playing a crucial role in recapitalizing credit institutions if needed.

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 fixed-income investments consisted of investment grade bonds and investment funds and 50% (+/-10%) of equity investments (investment funds and shares of companies) listed on the Helsinki Stock Exchange. Maximum of 10% of the investment portfolio can be allocated in alternative investments.

In H1 2024, MGB's liquidity in the form of fund and liquidity arrangements totaled €44 million, together with a committed credit line of €200 million with [Nordic Investment Bank](#) (Aaa stable). 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

MGB's financial performance remains strong, with a focus on maintaining liquidity and managing investment risks. We consider MGB's liquidity as low compared with its outstanding guarantee stock, which amounted €47 billion as of June 2024. 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 €6.1 billion in cash reserves (as of 31 December 2023) down from €7 billion a year before, representing strong 26% of sector operating revenue. Municipalities could use its cash reserves to support MGB in unlikely event of need.

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, using an execution decree. In a hypothetical scenario where MGB is seeking to recover sums owed to creditors, it would send all members municipalities

a bill in proportion to each member municipality's share of the payments. In a possible distress scenario, pre-emptive support could be forthcoming from either MGB member municipality or MGB itself.

A mitigating factor is the financial health of Finnish local government sector, which maintains its strength thanks to comprehensive financial support packages from the central government as evidenced between 2020 and 2022 as well as the knowledge-based economy, which supports the municipal tax revenue generation. In addition, MuniFin and MGB could take several early steps to prevent triggering the MGB guarantee mechanism.

ESG considerations

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 MGB 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 and scorecard factors

The principal methodology used in the rating of this entity is the [Government-Related Issuers](#) rating methodology, published in January 2024.

Ratings

Exhibit 3

Category	Moody's Rating
MUNICIPAL GUARANTEE BOARD	
Outlook	Stable
Issuer Rating -Dom Curr	Aa1
MUNICIPALITY FINANCE PLC	
Outlook	Stable
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 Ratings

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