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Research Update:

Swedish Region of Vastra Gotaland 'AAA/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

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Table Of Contents

Overview

Rating Action

Outlook

Rationale

Key Statistics

Ratings Score Snapshot

Key Sovereign Statistics

Related Criteria

Related Research

Ratings List

Research Update:

Swedish Region of Vastra Gotaland 'AAA/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

Overview

- We do not expect the political uncertainty following the recent general election in Sweden will have a material impact on Västra Götaland's budgetary and debt performance.
- Reflecting an increasing completion rate of investments, we now expect Västra Götaland to post deficits, though very limited.
- We are affirming our 'AAA/A-1+' global scale and 'K-1' regional scale ratings on Västra Götaland.
- The stable outlook reflects our view that Västra Götaland will be able to sustain higher investment levels while keeping low debt and exceptional liquidity.

Rating Action

On Oct. 5, 2018, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the Swedish Region of Västra Götaland. The outlook is stable.

At the same time, we affirmed our 'K-1' Nordic regional scale rating on Västra Götaland.

Outlook

The stable outlook reflects our expectation that Västra Götaland can sustain increased investments over the coming two years, while maintaining very limited deficits. As such, we expect the region will maintain a low debt burden and exceptional liquidity over the same period.

Downside scenario

We could take a negative rating action on Västra Götaland if expenditure growth led to a sharp increase in the deficit after capital accounts without any reaction by management. In this case, the county would likely start actively depleting cash reserves or accumulating debt far beyond our current expectations.

Rationale

Västra Götaland--Sweden's second-largest county--operates under the extremely predictable and supportive institutional framework in the country. In our view, Västra Götaland's local economy is strong and the population continues to grow by more than 1% a year. We still observe issues on the expenditure side limiting overall flexibility, but this is compensated by growth in tax revenues and grants through the equalization system. Our view on the region's liquidity position, together with its budgetary performance, continues to support the rating.

Västra Götaland benefits from its local economy and the equalization system

The foundation for all rated Swedish local and regional governments (LRGs) is the institutional framework and the comprehensive equalization system, which we continue to view as a key component of our ratings on Västra Götaland. In our view, the equalization system and widespread tax autonomy provide a high degree of institutional stability. As the second-largest region in Sweden and with unemployment levels currently well below the national average, Västra Götaland enjoys a strong local economic environment, a strength that underpins our assessment of the region's credit standing. We view the local economy as diverse and well balanced. Thanks to the region's economic growth, management has been able to use some flexibility to preserve sound operating balances, although the structural issues pushing up expenditures persist. We also observe some political uncertainties following the recent general elections in Sweden, but we expect revisions and investments will be consensus driven and not represent a big shift in financial strategy for Västra Götaland. We anticipate the region will continue to exercise very strong debt and liquidity management in a period of financing needs for increased investments. Similarly, the public transport company Västtrafik has predictable cash flow needs since management keeps performance in line with budgets.

Although the share of revenues that the region can adjust through its tax rate is high and management has shown its willingness to use it in the past, the expenditure structure in the region's hospital operations and personnel limits the overall flexibility. Despite this limited flexibility, we expect Västra Götaland's management would be able to adapt its budget to offset temporary pressure on budgetary performance.

Despite higher investments, we expect deficits to remain limited and debt accumulation low, thanks to high liquidity reserves

The region has a track record of strong budgetary performance and robust cash flows. Its operating balance was 6.6% of operating revenues in 2017. With investments at Swedish krona (SEK) 3.8 billion (about \$430 million)--and increasing by 20% from 2016--the region posted a surplus after capital accounts of 0.7% of total revenues. We expect expenditures will outgrow tax revenues in 2018, which will lead to an operating balance of 5.7% of operating revenues for 2018.

We also project that, over 2018-2020, Västra Götaland's capital expenditures will continue to rise, based on the goal of increasing the completion rate, which has been successful in both 2017 and 2018. The region's investments are largely aimed at property maintenance, upgrades of hospital buildings and equipment, and large infrastructure initiatives in public transport through Västtrafik. Based on the increase in investments carried out in the past two years, we have revised up our forecast of expected capital expenditures to an average of about SEK5.1 billion annually over 2018-2020, from SEK3.4 billion over 2015-2017. This is still below the region's planned volumes, due to expected delays of investments and constraints in capacity. The uptick in investment levels will likely lead to deficits after capital accounts in the coming years, though limited and below 2% of total revenues over 2018-2020.

In the planning period through 2020, we expect Västra Götaland will finance deficits through its existing liquidity and not through further debt issuance. As such, we expect that the liquidity reserves will decrease, subject to valuation gains. As a result, Västra Götaland's debt burden will remain at current very low levels through year-end 2020. However, the region's gross pension liabilities, which we treat as debt, comprise about 70% of operating revenues and weigh on our analysis of the region's overall debt position.

We view Västra Götaland's liquidity as a key strength for the rating, with cash and liquid investments (after haircuts) totaling SEK12.3 billion as of Sept. 21, 2018. Prudent investment guidelines are in place, and we are not aware of any material risk exposure in the region's investment portfolios. When assessing Västra Götaland's liquidity, we view positively the region's strong access to the capital markets. The region has no debt repayments in the short term and it has substantial liquidity reserves, leading to excellent debt service coverage. Additional liquidity is available through a SEK750 million checking account, which the region uses as liquidity backup.

We consider Västra Götaland's co-ownership of rolling stock leasing company AB Transitio and the related guarantee arrangements in our assessment of the region's contingent liabilities. However, we assess the ultimate recapitalization risk linked to this company to be limited for Västra Götaland.

Key Statistics

Table 1

Vastra Gotaland (Region of) Selected Indicators						
	--Year ended Dec. 31--					
	2015	2016	2017	2018bc	2019bc	2020bc
(Mil. SEK)						
Operating revenues	57,388	60,775	62,808	65,177	67,379	69,297
Operating expenditures	53,539	55,957	58,667	61,490	63,139	64,474
Operating balance	3,849	4,818	4,141	3,687	4,240	4,823

Table 1

Vastra Gotaland (Region of) Selected Indicators (cont.)						
	--Year ended Dec. 31--					
	2015	2016	2017	2018bc	2019bc	2020bc
Operating balance (% of operating revenues)	6.7	7.9	6.6	5.7	6.3	7.0
Capital revenues	19	64	90	0	0	0
Capital expenditures	3,292	3,108	3,767	4,900	5,200	5,350
Balance after capital accounts	576	1,774	464	(1,213)	(960)	(527)
Balance after capital accounts (% of total revenues)	1.0	2.9	0.7	(1.9)	(1.4)	(0.8)
Debt repaid	29	60	139	0	0	0
Gross borrowings	0	0	11	1,000	0	0
Balance after borrowings	(255)	2,420	1,027	(213)	(960)	(527)
Modifiable revenues (% of operating revenues)	73.4	72.8	73.8	73.8	73.8	73.9
Capital expenditures (% of total expenditures)	5.8	5.3	6.0	7.4	7.6	7.7
Direct debt (outstanding at year-end)	278	247	201	1,201	1,201	1,201
Direct debt (% of operating revenues)	0.5	0.4	0.3	1.8	1.8	1.7
Tax-supported debt (outstanding at year-end)	352	319	273	1,273	1,273	1,273
Tax-supported debt (% of consolidated operating revenues)	0.6	0.5	0.4	2.0	1.9	1.8
Interest (% of operating revenues)	0.0	0.0	0.0	0.0	0.0	0.0
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	431,044	445,182	458,112	474,431	490,435	507,430

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. SEK--Swedish krona.

Ratings Score Snapshot

Table 2

Vastra Gotaland Ratings Score Snapshot	
Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Average
Budgetary performance	Very strong
Liquidity	Exceptional
Debt burden	Low
Contingent liabilities	Very low

S&P Global Ratings bases its ratings on local and regional governments on the 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," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Research Update: Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 31, 2018

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- 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, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sovereign Risk Indicators, July 5, 2018. An interactive version is available at www.spratings.com/sri.
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 2018
- S&P Global Ratings Definitions, April 19, 2018
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Public Finance System Overview: Swedish Local And Regional Governments, June 15, 2017
- Swedish Local And Regional Government Risk Indicators: April 2017 Update, April 5, 2017

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

Ratings Affirmed

Vastra Gotaland (Region of)

Issuer Credit Rating	AAA/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Commercial Paper	K-1

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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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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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