

Research Update:

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

October 4, 2019

Overview

- We expect Västra Götaland's management to maintain prudent debt and liquidity management in a period of increasing investment needs.
- At the same time, high demand on healthcare services and rising pension cost constrain budgetary performance and flexibility, and we anticipate temporary deviations from the balanced budget requirement.
- We are affirming our 'AAA/A-1+' global scale and 'K-1' regional scale ratings on Västra Götaland. The outlook is stable.

Rating Action

On Oct. 4, 2019, 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, over the coming two years, Västra Götaland can sustain increased investments, while maintaining minimal debt and exceptional liquidity.

Downside scenario

We could take a negative rating action on Västra Götaland if expenditure growth led to a structural deterioration in budgetary performance and a sharp increase in the deficit after capital accounts without any countermeasures from management. In this case, we assume the region would likely erode its cash reserves or accumulate debt far beyond our current expectations.

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Rationale

Our ratings on Västra Götaland remain underpinned by the supportive Swedish institutional framework, the region's wealthy local economy, and its conservative debt and liquidity management, which shows in its very low debt levels and outstanding liquidity coverage. At the same time, rising and rigid expenditures from demographic changes and increasing pension costs hamper the region's budgetary flexibility.

Västra Götaland benefits from its wealthy local economy, institutional stability, and Sweden's equalization system

We regard Sweden's institutional framework as a key strength in our ratings on Swedish local and regional governments (LRGs), including Västra Götaland. In our view, the system is extremely predictable and supportive, and it has a high degree of institutional stability, alongside revenue and expenditure management based on a far-reaching equalization system and local tax autonomy. This promotes high financial reporting and disclosure standards, as well as fiscal discipline among Sweden's LRGs.

In addition, Västra Götaland benefits from the very strong economic fundamentals in Sweden, as reflected in high GDP per capita, which we estimate at Swedish krona (SEK) 485,433 (about \$53,300) in 2019. The local economy in Västra Götaland is wealthy. As the second-largest region in Sweden and with unemployment levels currently below the national average, Västra Götaland draws credit strength from its sound and diverse local economic environment.

Following the September 2018 elections, the ruling government remained in power but in the minority. We believe this shift could result in somewhat weakened executive power but that the overall direction and financial strategy will remain intact thanks to a consensus on fiscal policies.

We consider the region's financial management as strong with a conservative stance on debt and liquidity management and a commitment to budgetary discipline. We anticipate the region will continue to exercise prudent financial management in a period of increasing cost pressure and high investments needs. However, we note that management has demonstrated limited ability to control costs in the large hospitals; we believe this could create temporary deviations from the balanced budget requirement over the forecast period.

Despite higher investments, deficits will likely remain narrow, with limited debt accumulation, thanks to ample liquidity reserves

The region has a track record of sound budgetary performance and robust cash flows. We expect its operating balance to remain strong on a cash flow basis at 6.8% of operating revenues on average for 2019-2021, up from 6.3% in 2018. However, due to higher investment levels, the region posted a deficit after capital accounts of 1.9% in 2018. We believe management will be able to keep deficits moderate, even during periods of elevated investment so that deficits average less than 3% through 2021.

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. We estimate that total investments will average Swedish krona (SEK) 6.8 billion annually in 2019-2021. We also note that pension-related expenditures constitute an increasing portion of the region's budget. In our view, these expenditures are difficult to adjust, crowd-out

other expenditures, and hamper the region's budgetary flexibility.

Västra Götaland has historically been debt free and finances its investment through cash flow from operations and occasionally by using its liquid assets. However, in 2018 the region issued its inaugural bond and we understand that management is opening up to external financing of certain types of investment. As such, we anticipate investments linked to railway infrastructure to be financed externally, while investments related to core activities will continue to be funded from internal cash flows and existing liquidity sources. Consequently, we project a decline in liquid assets and a marginal uptick in external debt. Nevertheless, we project that Västra Götaland's debt burden will remain light, with tax-supported debt staying below 5% of operating revenues through end-2021.

We view Västra Götaland's liquidity as a key rating strength, with cash and liquid investments estimated at about SEK10 billion at end-2019. Additional liquidity is available through a SEK750 million checking account, which the region uses as liquidity backup. We factor into our liquidity calculations for Västra Götaland temporary use of commercial paper in 2019-2020 of SEK500 million, but the region does not have any other debt repayment in the short term. This leads to excellent debt service coverage, with available liquidity sources estimated at more than 10x of the next 12 months of debt service. Prudent investment guidelines are in place, and we are not aware of any material risk exposure in the region's investment portfolios. Also, when assessing Västra Götaland's liquidity, we view positively the region's strong access to the capital markets.

Key Statistics

Table 1

Region of Västra Götaland Selected Indicators

(MIL. SEK)	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	60,775	62,808	65,929	68,316	70,860	73,033
Operating expenditures	55,957	58,667	61,743	64,168	65,979	67,631
Operating balance	4,818	4,141	4,186	4,148	4,881	5,402
Operating balance (% of operating revenues)	7.9	6.6	6.3	6.1	6.9	7.4
Capital revenues	64	90	62	0	0	0
Capital expenditures	3,108	3,767	5,477	6,840	6,707	6,883
Balance after capital accounts	1,774	464	(1,229)	(2,692)	(1,826)	(1,481)
Balance after capital accounts (% of total revenues)	2.9	0.7	(1.9)	(3.9)	(2.6)	(2.0)
Debt repaid	60	139	190	0	500	0
Gross borrowings	0	11	1,061	500	1,412	898
Balance after borrowings	2,420	1,027	(213)	(2,192)	(914)	(584)
Direct debt (outstanding at year-end)	247	97	1,115	1,615	2,527	3,377
Direct debt (% of operating revenues)	0.4	0.2	1.7	2.4	3.6	4.6
Tax-supported debt (outstanding at year-end)	319	169	1,188	1,688	2,600	3,450
Tax-supported debt (% of consolidated operating revenues)	0.5	0.3	1.8	2.5	3.7	4.7

Table 1

Region of Västra Götaland Selected Indicators (cont.)

(Mil. SEK)	2016	2017	2018	2019bc	2020bc	2021bc
Interest (% of operating revenues)	0	0	0	0	0	0
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	445,182	458,105	473,294	485,433	498,816	514,531

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. SEK--Swedish krona. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Region of Västra Götaland Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	2
Liquidity	1
Debt burden	1
Stand-alone credit profile	aaa
Issuer credit rating	AAA

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Summary: Sweden, Aug. 23, 2019

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sweden's Local Governments To Get A Slight Boost From 2020 Budget, Sept. 20, 2019
- S&P Global Ratings Definitions, Sept. 18, 2019
- Sweden's Municipal Sector Faces An Equalization Shake-Up, Sept. 13, 2019
- Summary: Sweden, Aug. 23, 2019
- Sovereign Risk Indicators, July 11, 2019. An interactive version is available at www.spratratings.com/sri.
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- A Potential Profit Cap On Private Operators In Sweden's Welfare Sector Could Increase LRG Spending, March 11, 2019
- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 22, 2019
- Public Finance System Overview: Swedish Municipalities And Counties, Jan. 21, 2019
- European Local And Regional Government Risk Indicators, Nov. 9, 2018
- Sweden's Unclear Parliamentary Situation Clouds Local Governments' Future Financial Policy, Oct. 4, 2018

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+
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Ratings Affirmed

Nordic Regional Scale --/--/K-1

Commercial Paper K-1

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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