

Research Update:

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

September 29, 2023

CreditWire Vendor Headline: S&PGR Affirms Vastra Gotaland Region At 'AAA/A-1+'; Otlk Stbl

Overview

- Inflationary pressure and higher pension costs will result in somewhat weaker, albeit still sound, operating surpluses for the Swedish Region of Vastra Gotaland (Västra Götaland) after an extraordinarily strong performance in 2021-2022.
- Västra Götaland's debt should stay low on the back of historically accumulated budgetary surpluses.
- The region is likely to have exceptionally high holdings of cash and liquid assets at about Swedish krona (SEK)15 billion, representing about 2x direct debt.
- We therefore affirmed our 'AAA/A-1+' ratings on the region of Västra Götaland with a stable outlook.

Rating Action

On Sept. 29, 2023, 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 indicates that we expect the Region of Västra Götaland will counteract budgetary pressure stemming from inflation and rising health care costs associated with demographic changes. This will enable the region to keep debt low while maintaining exceptional liquidity amid sizable capital investments.

Downside scenario

We could lower the ratings on Västra Götaland if we observed a structural weakening of the

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region's financial policy, leading to widening deficits after capital accounts or failure to comply with regulatory requirements, potentially caused by a rapid increase in expenditure.

Rationale

The 'AAA' rating on Västra Götaland reflects our view of the high predictability and supportiveness of Sweden's institutional framework. It also reflects the region's wealthy local economy and its conservative debt and liquidity management, which result in its very low debt and outstanding liquidity coverage. We expect the region's budgetary performance will remain solid through to 2025, albeit weaker than in 2021-2022. This includes steady tax revenue growth that will counterbalance inflationary cost pressures over the forecast period. However, rising and rigid expenditure linked to demographic changes and higher pension costs has constrained the region's budgetary flexibility.

We expect management will remain committed to prudent debt and liquidity policies, while the strong local economy and Sweden's robust institutional framework will continue to underpin the rating

We consider the region's financial management is strong and there is political consensus on broad operational matters. Therefore, we view it as unlikely that fiscal risks would emerge from the transition to Västra Götaland's new ruling coalition. We believe the region will continue to exercise prudent debt and liquidity management and stay committed to budgetary discipline, even though capital spending needs remain high.

The region benefits from Sweden's very strong economic fundamentals. Households across the region enjoy relatively strong net worth, translating into stable tax revenues. In addition, the region's significant automotive industry is investing, among other things, in the conversion to electric vehicles.

We regard the institutional framework in Sweden as extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the local and regional government (LRG) sector's revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. Furthermore, the central government's swift response to the COVID-19 pandemic, partly through the distribution of general grants to the LRG sector, supports our view. Although demographic challenges persist and we expect the LRG sector's budgetary performance to weaken as extraordinary support is phased out, we see limited risk of a material deterioration in its finances.

Strong tax revenue developments should counterbalance inflationary pressure, while exceptional liquidity holdings and low debt are key rating strengths

The regional economy continues to expand strongly and support tax revenue growth. We forecast that Västra Götaland's tax revenue will remain robust in nominal terms over the coming years. Although inflationary pressure and higher pension-related costs will affect expenditure, we believe Västra Götaland is well placed to maintain its operating surplus of 5.7% of operating revenue on average for 2023-2025. Pension-related expenditure constitutes an increasing portion of the region's budget, however, which can crowd out other expenditure, hampering the region's budgetary flexibility.

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We project capital expenditure (capex) will remain elevated and that Västra Götaland will have small deficits after capex on average. The region's investments are largely aimed at property maintenance, upgrading hospital buildings and equipment, and large public transport projects through Västtrafik. We estimate that annual investments will average SEK6 billion in 2023-2025, facilitated by still strong cash flow, as per our base-case projection.

Västra Götaland has limited volumes of debt. It mainly finances its investments via cash flow from operations, supplemented occasionally by taking up debt or using its liquid assets. Therefore, we anticipate the debt burden will remain very low, with tax-supported debt reaching a modest 11% of operating revenue through 2025. We expect Västra Götaland will raise most of its external financing through the Public Sector Funding Agency Kommuninvest i Sverige AB (Kommuninvest; AAA/Stable/A-1+). By becoming a member of the agency it signed a joint and several guarantee implying that the region could be called on to repay a claim on Kommuninvest. However, we consider the potential recapitalization cost of Kommuninvest to be very low. As such, the guarantee commitment does not alter our view of Västra Götaland's contingent liabilities as limited.

We view Västra Götaland's liquidity as a key rating strength. After applying haircuts, we include in our assessment liquid assets of SEK15 billion. Although part of this liquidity portfolio is earmarked for pension payments, we believe these funds would be available for debt service if needed. We therefore include these assets in our liquidity analysis. Additional liquidity is available through a SEK750 million checking account. Västra Götaland's debt maturities are covered by the region's cash and liquid assets by a comfortable 590%, and we note the region's strong access to markets.

Key Statistics

Table 1

Vastra Gotaland (Region of) selected indicators

	--Year ended Dec. 31--					
	2020	2021	2022	2023bc	2024bc	2025bc
Mil. SEK						
Operating revenues	71,944	77,979	80,588	82,042	85,725	88,609
Operating expenditures	66,445	69,918	72,108	77,056	81,211	83,445
Operating balance	5,499	8,061	8,480	4,986	4,514	5,164
Operating balance (% of operating revenues)	7.6	10.3	10.5	6.1	5.3	5.8
Capital revenues	172	143	142	140	140	140
Capital expenditures	5,566	5,374	5,014	5,859	6,175	6,175
Balance after capital accounts	105	2,830	3,608	(733)	(1,521)	(871)
Balance after capital accounts (% of total revenues)	0.1	3.6	4.5	(0.9)	(1.8)	(1.0)
Debt repaid	66	70	1,700	1,640	2,695	910
Gross borrowings	3,340	4,810	3,067	1,170	4,716	1,781
Balance after borrowings	5,542	2,565	2,427	(1,203)	500	0
Direct debt (outstanding at year-end)	4,992	6,051	7,418	6,948	8,969	9,839
Direct debt (% of operating revenues)	6.9	7.8	9.2	8.5	10.5	11.1

Table 1

Vastra Gotaland (Region of) selected indicators (cont.)

	--Year ended Dec. 31--					
	2020	2021	2022	2023bc	2024bc	2025bc
Tax-supported debt (outstanding at year-end)	5,071	6,131	7,495	7,025	9,046	9,916
Tax-supported debt (% of consolidated operating revenues)	7.0	7.9	9.3	8.6	10.6	11.2
Interest (% of operating revenues)	0.0	0.0	0.1	0.1	0.2	0.2
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	487,872	528,606	572,067	599,206	613,516	632,009

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. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

Vastra Gotaland (Region of) ratings score snapshot

Key rating factors

Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	1
Stand-alone credit profile	aaa
Issuer credit rating	AAA

Key Sovereign Statistics

- Sovereign Risk Indicators, July 10, 2023. An interactive version is available at <http://www.spratings.com/sri>

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

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- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Sweden's Local And Regional Governments Have Less Room To Maneuver Over The Next Year As Pension Costs Rise, Sept. 14, 2023
- Institutional Framework Assessments For International Local And Regional Governments Outside Of The U.S., March 22, 2023
- Most Rated Swedish LRGs Can Absorb Higher Interest Costs, Sept. 12, 2022
- Southern Swedish LRGs Bear The Brunt Of Surging Electricity Prices, Jul. 20, 2022
- Swedish Local Governments Are Holding Up Against Cyber Attacks, Jan. 26, 2022
- Institutional Framework Assessment: Swedish Municipalities And Counties, Dec. 13, 2021

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

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.spglobal.com/ratings for further information. A description of each of

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