

Research Update:

Swedish City Of Vasteras 'AAA/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

September 13, 2019

Overview

- Given Vasteras' growing population, we expect capital expenditure (capex) to remain high through our forecast period to end-2021.
- We expect management will remain committed to budgetary discipline to counteract pressure on tax revenue growth and from demographic-related expenditure.
- We are affirming our 'AAA/A-1+' and 'K-1' ratings on Vasteras.
- The outlook is stable.

Rating Action

On Sept. 13, 2019, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term foreign and local currency issuer credit ratings on the Swedish city of Vasteras. The outlook remains stable.

We also affirmed our 'K-1' short-term Nordic regional scale rating on Vasteras.

Outlook

The stable outlook reflects our base-case expectation that Vasteras will continue its prudent approach to managing expenditure and maintain its ample liquidity buffers. In our base case, we also assume that the city will prudently manage its ongoing investment program, and that of its municipal companies, resulting in only marginally higher debt ratios. That said, we note that both existing and new loans will primarily constitute on-lending to the city's healthy company sector, which services its own debt.

Downside scenario

We could take a negative rating action if the city's operating balance turns into a deficit, or if higher-than-expected levels of investment result in capex deficits sustainably below our forecast.

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In such a scenario, we could lower our assessment of Vasteras' financial management if the city proved unable to resolve these scenarios by increasing revenue or cutting operating expenditure.

Rationale

We believe Vasteras' will continue operating with a robust liquidity position. Budgetary performance is expected to remain at an adequate level, although somewhat below its stated surplus target, despite increased expenditure and investment needs stemming from the city's changing demography. Proactive management, revenue flexibility, and a debt structure mainly comprising on-lending to the corporate sector will remain central to our base case. Furthermore, although we believe that debt-funded investments will result in somewhat higher debt in nominal terms, we now think Vasteras' debt will stabilize at the end of our forecast period.

Sweden's institutional framework, strong local economy and prudent management support the city's fundamentals

Since its 2018 election, Vasteras has been governed by a majority coalition of Social Democrats, the Green party, the Center party, and the Liberal party, the latter of which joined the ruling coalition instead of the Christian Democrats. So far, we have not observed any significant changes, since there is broad political consensus on long-term strategies for governing the city. Given our understanding that Vasteras' new government will provide a high degree of policy continuity, we do not expect a major financial policy shift in the medium term.

On balance, we consider Vasteras' financial management as very competent and prudent, with effective cost controls and sound debt and liquidity management. In 2019, we expect rising capex will heighten the city's funding needs, but we believe it will be able to contain risk and ensure strong liquidity. In our view, Vasteras will continue its track record of prudent and sophisticated management of budgetary performance, debt, and liquidity. Budgeting procedures show a high degree of transparency, and formal rules stipulate processes and levels of financial disclosure. Given budgetary challenges in both the operating and capital accounts, we believe the city will use its revenue flexibility, if necessary, to achieve balanced budgets.

We consider Sweden's institutional framework for local and regional governments (LRGs) extremely predictable and supportive. This is a key component of our ratings on Swedish LRGs, because the system has a high degree of institutional stability and revenue and expenditure management is based on a far-reaching equalization system and autonomy in setting local taxes.

We believe Sweden's economic fundamentals are very strong, based on our 2019 estimate of national GDP per capita of approximately Swedish krona (SEK) 485,433 (about \$53,300). In our view, Vasteras' local economy is fairly strong when compared nationally, with high income levels, good infrastructure, and a rapidly increasing population. However, an inflow of jobseekers has led to unemployment levels slightly above the national average.

Weakening budgetary performance is counterbalanced by flexibility to boost cash flows, debt on-lending to a healthy company sector, and a robust liquidity position

Vasteras' budgetary performance has been consistently average in recent years, despite increasing cost pressure stemming from its changing demography. For 2019, we expect performance to weaken somewhat, negatively deviating from internal targets due to slower tax

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revenue growth and pressure from social welfare-related spending. For 2017-2021, we expect Vasteras' operating balance will average 4.3% of operating revenue, marginally below our previous review. We also anticipate further pressure on operating expenditure due primarily to demographic factors, although we expect management will apply strict cost controls to limit this pressure.

Due to sustained investments, we expect Vasteras will demonstrate a deficit after capital accounts of 3.2% of revenue on average in 2017-2021. Our previous forecast was a deficit of 1.1% of revenue. The updated budget document, published in mid-2019, specifies higher investment levels throughout the forecast period, especially in 2021, than previously. The difference is primarily attributable to Mälarporten, an ambitious project building a new neighborhood at the center of Vasteras that has been added to the capex plan.

In our view, Vasteras has above average revenue flexibility to mitigate any significant budgetary deterioration. The city's comparably strong per-capita tax base, combined with its low local tax rate (below the national and county averages) and full autonomy in deciding its tax rate, mean that it has considerable headroom to increase tax revenue if needed. Furthermore, Vasteras has a proven track record and declared willingness to divest assets, the proceedings from which can be used to repay debt.

The city of Vasteras acts as an in-house bank, and on-lends all debt to its company sector, where the largest entities are housing company Mimer and energy company Mälarenergi. We continue to expect that the companies' investments will require additional loan funding, which will come via further on-lending from the in-house bank. However, we forecast the company sector's borrowing needs will decrease after 2021, thanks to the completion of the combined heat and power plant at Mälarenergi.

For our indicative debt ratio, we use direct debt to assess Vasteras' debt burden instead of tax-supported debt. This is because the inclusion of company sector revenue in calculations of tax-supported debt makes the ratio look overly strong. We expect Vasteras' direct debt to reach 125% of adjusted operating revenue by year-end 2021, slightly higher than our previous forecast. In assessing Vasteras' debt, we take into account that it is all on-lent to the financially and operationally strong company sector. The lion's share of on-lent debt is directed to companies with robust financial positions and a proven ability and willingness to timely service debt.

Vasteras' healthy mix of own-source liquidity and contracted facilities, in combination with strong market access, underpin its exceptionally strong liquidity position. We calculate that Vasteras' liquidity sources cover 140% of the upcoming 12 months of debt service. In our view, the city treasury is committed to prudent and risk-minimizing policies that will help maintain the coverage ratio well above 120%. Furthermore, we believe Vasteras benefits from strong, ready, and reliable access to external liquidity, similar to that of other LRGs we rate in Sweden.

Key Statistics

Table 1

City of Vasteras Selected Indicators

	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	9,563	10,031	10,424	10,583	11,020	11,333
Operating expenditures	9,104	9,403	10,002	10,194	10,607	10,907
Operating balance	459	628	422	389	413	426

Table 1

City of Vasteras Selected Indicators (cont.)

	2016	2017	2018	2019bc	2020bc	2021bc
Operating balance (% of operating revenues)	4.8	6.3	4.0	3.7	3.7	3.8
Capital revenues	197	170	218	200	200	200
Capital expenditures	397	600	977	1,152	1,207	1,098
Balance after capital accounts	259	198	(337)	(563)	(594)	(472)
Balance after capital accounts (% of total revenues)	2.7	1.9	(3.2)	(5.2)	(5.3)	(4.1)
Debt repaid	3,763	4,582	3,962	2,450	4,000	4,300
Gross borrowings	4,342	4,843	4,178	4,524	5,463	5,371
Balance after borrowings	(83)	289	(93)	0	0	0
Direct debt (outstanding at year-end)	9,095	9,356	9,572	11,646	13,109	14,180
Direct debt (% of operating revenues)	95.1	93.3	91.8	110.0	119.0	125.1
Tax-supported debt (outstanding at year-end)	9,335	9,586	9,796	11,876	13,339	14,410
Tax-supported debt (% of consolidated operating revenues)	66.7	66.3	65.5	78.1	84.7	89.2
Interest (% of operating revenues)	0.8	0.9	0.7	1.1	1.1	1.0
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	445,182	458,105	473,294	485,433	500,290	517,575

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

City of Vasteras Ratings Score Snapshot

Table 2

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

Key Sovereign Statistics

- Sovereign Risk Indicators, July 11, 2019. An interactive version is also available at www.spratings.com/sri

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

- S&P Global Ratings Definitions, July 5, 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

Vasteras (City of)

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

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