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Research Update:

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

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Overview

- Västerås' budgetary performance is developing in line with our previous base-case assumptions, as well as with the city's forecasts and financial targets through 2020.
- We expect debt accumulation will slow compared with our previous base-case projections, due to the city's revised capital expenditure program and the imminent sale of property at its housing company.
- We are affirming our 'AAA/A-1+' and 'K-1' ratings on Västerås.
- The stable outlook reflects our view that the city's prudent financial management and ample liquidity buffers will counterbalance any risks arising from temporarily heightened spending needs and structural demographic pressures.

Rating Action

On March 16, 2018, 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 Västerås. The outlook remains stable.

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

Outlook

The stable outlook reflects our base-case expectation that Västerås' financial management will continue its prudent approach over the next two years 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, with somewhat higher debt. That said, we expect the increase will primarily constitute onlending to the city's creditworthy housing and energy companies, and therefore not trigger the need for a tax rise or cost-cutting pressure on its operations.

Downside Scenario

We could lower the ratings under our downside scenario if we observed significant deterioration in Västerås' liquidity position and deviation from its policies that lead us to revise downward our assessment of both its

liquidity position and financial management.

Rationale

The ratings primarily reflect our view that Västerås will continue to benefit from an extremely predictable and supportive institutional framework, exceptional liquidity, and very strong financial management. The city's very strong local economy, strong budgetary flexibility, and low contingent liabilities further underpin the ratings. The city's average budgetary performance and rising, although still moderate, debt somewhat offset these positive rating factors.

We affirmed the ratings because we assume in our base case that Västerås' liquidity position and budgetary performance will remain stable and in line with its financial targets, despite increased expenditures and investment needs stemming from the city's changing demography. Management's prudent approach and the city's ample revenue flexibility will remain central to our base case. Additionally, although we believe that debt-funded investments will result in somewhat higher debt, we now think Västerås' debt could start decreasing toward the end of our forecast period through 2020.

A very strong institutional framework, wealthy economy, and well-functioning management remain key strengths

Västerås' economy is strong in a global comparison, with sound growth prospects and an average population growth rate of 1.5% over the past three years. We consider the economy to be well balanced, with a diverse industry structure that focuses on high-tech engineering. Nevertheless, a strong inflow of job-seekers from surrounding areas and immigration have led to somewhat higher structural unemployment than the national average. Because Västerås hosts several engineering companies, income levels are slightly above average for Sweden and high by international standards. Owing to Sweden's comprehensive equalization system, which evens out wealth among local and regional governments (LRGs), we use the three-year average national GDP per capita of \$52,456 for 2015-2017 as the starting point of our analysis of Västerås.

We believe Västerås' management 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. On balance, we consider Västerås' financial management to be very strong. Rising capital expenditures (capex) are heightening the city's funding needs, but we consider its financial management able to contain risk and ensure strong ongoing liquidity. We expect the city will continue to exercise very strong debt and liquidity management to cope with its expanding loan portfolio. With budgetary challenges on both the operating and capital accounts, we still believe the city would use its revenue flexibilities if necessary to achieve balanced budgets. The city has several options at its disposal, for example, the sale

of assets or increase of income tax.

We view Sweden's extremely predictable and supportive institutional framework as a key component of our ratings on Västerås. In our view, the system displays a high degree of institutional stability. The LRG sector's revenue and expenditure balance is based on a far-reaching equalization system and autonomy in setting local taxes. In this regard, we assess the city as having strong, overall budgetary flexibility, and we estimate its modifiable revenues at close to 70% of operating revenues over 2018-2020.

Stable budgetary performance, slower debt accumulation, and continued very strong liquidity

Thanks to robust economic fundamentals and prudent financial management, Västerås has posted consistently average budgetary performance over recent years, counterbalancing increasing cost pressure stemming from its changing demography. For 2017, Västerås posted stronger-than-targeted budgetary performance, achieving a surplus of Swedish krona (SEK) 518 million (or \$63 million), which is SEK372 million above budget. The operating surplus increased to 7.3% of revenues in 2017 from 4.8% in 2016, whereas the after-capex surplus remained broadly unchanged at 2.8%. Expenditures developed in line with the city's budget, while both operating and tax revenues outperformed the budget. Overall, Västerås has been successful in containing cost increases in core service areas.

Västerås' forecast budgetary performance until 2020 is broadly in line with our previous forecast. In our base-case scenario, we expect the city's operating balance will average 4.2% of operating revenues over 2018-2020, assuming that the city continues managing the cost of core services, while benefiting from higher tax revenues. Due to sustained investments, we expect Västerås will demonstrate a modest deficit after capital accounts of 2.1% of revenues on average in 2018-2020.

In our view, Västerås has the revenue flexibility to mitigate almost any significant budgetary deterioration, which is important in light of our assessment of the municipality's somewhat rigid expenditure structure. Although Västerås' operating expenditure structure is quite inflexible, the municipality's comparably strong per-capita tax base means that it has a rather high share of modifiable revenues. Even though this share has reduced somewhat since our last review, due to an increase in central government grants, Västerås' flexibility to generate revenues in other areas, such as via potential asset sales counterbalance this constraint, in our view. In addition, Västerås' municipal tax rate is below the national and county averages, which further boosts its income-generation capacity.

We acknowledge that the lion's share of Västerås' group investments is delivered by its company sector, in particular by energy utility Mälarenergi and public housing company Bostads AB Mimer, which are both undergoing considerable expansion. We continue to expect that the municipal companies' investments will require additional loan funding, which will come via further onlending from the city treasury. We estimate the required onlending for the

two companies will average a sizable SEK1.2 billion per year over the 2018-2020 planning period, which will likely result in additional borrowing for the city. In our base case, we expect Västerås' direct debt will reach about 121% of operating revenues in 2020, up from 93% in 2017. However, since our last review, Mimer has reduced its capex plans, which--combined with an impending property sale--has led to a significantly reduced forecast for debt accumulation.

In assessing Västerås' debt, we regard as positive that the city has no loans for its core municipal activities and that the debt held in the city treasury is onlent to municipal companies. Additionally, these companies are financially sound, in particular Mimer, which we consider self-supporting. However, we also consider that our tax-supported debt metric is distorted by the inclusion of the municipal companies' substantial revenues. We therefore consider the city's direct debt to be a more appropriate metric for our assessment, since it reflects the risk associated with external loans at the city treasury.

We consider Västerås' contingent liabilities to be limited. Most of the municipal companies' debt is factored into our assessment of the city's debt burden because all of these companies receive loan funding from the city treasury. With regard to Mimer, for which the onlending has a positive impact on our assessment, recapitalization risk is minimal. This is because cash-flow risk is low, due to very low demand risk and a strong means of passing costs on to tenants. Furthermore, risks to Västerås' balance sheet are mitigated by ample surplus values. External guarantees are minimal and none have been called over the past several years. Västerås is not a member of public-sector funding agency Kommuninvest, and therefore has no contingent risk stemming from Kommuninvest's joint and several guarantee structure.

Västerås' liquidity position reflects its strong debt-service coverage. In January 2018, cash and committed facilities accounted for about 154% of debt service for the ensuing 12 months. We also incorporate in our liquidity assessment the city's strong access to external liquidity and funding needs in the coming years. Using our base-case estimates, the city's average cash and security investments totaled about SEK2.2 billion and average committed facilities and available checking accounts about SEK2.0 billion, supplemented by a SEK1.5 billion loan agreement with the European Investment Bank.

Key Statistics

Table 1

City of Vasteras Key Statistics						
	--Fiscal year end Dec. 31--					
(Mil. SEK)	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	8,822	9,563	10,036	10,256	10,640	10,998
Operating expenditures	8,464	9,104	9,304	9,814	10,196	10,546

Table 1

City of Vasteras Key Statistics (cont.)						
	--Fiscal year end Dec. 31--					
(Mil. SEK)	2015	2016	2017	2018bc	2019bc	2020bc
Operating balance	358	459	732	442	444	452
Operating balance (% of operating revenues)	4.1	4.8	7.3	4.3	4.2	4.1
Capital revenues	528	197	170	0	0	0
Capital expenditures	438	397	600	645	858	602
Balance after capital accounts	448	259	198	(203)	(414)	(150)
Balance after capital accounts (% of total revenues)	4.8	2.7	2.8	(2.0)	(3.9)	(1.4)
Debt repaid	4,566	3,763	4,582	3,962	3,800	4,300
Gross borrowings	5,542	4,342	4,843	4,907	5,776	5,378
Balance after borrowings	467	(83)	289	(415)	0	0
Modifiable revenues (% of operating revenues)	72.7	69.9	69.6	69.6	69.4	69.2
Capital expenditures (% of total expenditures)	4.9	4.2	6	6.2	7.8	5.4
Direct debt (outstanding at year-end)	8,516	9,095	9,356	10,301	12,277	13,355
Direct debt (% of operating revenues)	96.5	95.1	93.3	100.4	115.4	121.4
Tax-supported debt (outstanding at year-end)	8,763	9,335	9,586	10,531	12,507	13,585
Tax-supported debt (% of consolidated operating revenues)	66.6	66.7	66.3	68.1	77.5	81.1
Interest (% of operating revenues)	0.8	0.8	0.9	0.8	0.8	0.7
Local GDP per capita	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	430,872	447,142	462,177	478,637	493,266	508,093

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.

Ratings Score Snapshot

Table 2

City of Vasteras Ratings Score Snapshot	
Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Very strong
Budgetary flexibility	Strong
Budgetary performance	Average
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	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 rating.

Key Sovereign Statistics

Sovereign Risk Indicators - December 14, 2016, a free interactive version is available at <http://www.spratings.com/sri>

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- 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 - December 14, 2016, a free interactive version is available at <http://www.spratings.com/sri>

- Institutional Framework Assessments For Non-U.S. Local And Regional Governments - September 21, 2017
- 2016 Annual Non-U.S. Local And Regional Government Default Study And Rating Transitions - May 8, 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 agreed that the key rating factors were unchanged.

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

Vasteras (City of)	
Senior Unsecured	AAA
Commercial Paper	A-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 the 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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