

Research Update:

Outlook On Swedish City of Vasteras Revised To Negative; 'AAA' Ratings Affirmed

June 5, 2020

Overview

- Ongoing cost pressures from demographic factors, together with lower tax revenue because of COVID-19, are increasing the risk of Västerås' budgetary performance worsening over our 2021-2022 forecast period.
- We also expect debt to continue to increase because investment needs will remain high through 2022, stemming from Västerås' growing population--materially higher than the national average.
- We are therefore revising our outlook on the long-term ratings on Västerås to negative, while affirming the 'AAA/A-1+' ratings.
- That said, we expect management to maintain budgetary discipline, offsetting pressure on budgetary performance by using its fiscal flexibility.

Rating Action

On June 5, 2020, S&P Global Ratings revised its outlook on the Swedish city of Västerås to negative. We affirmed our 'AAA' long-term foreign and local currency issuer credit ratings, and our 'A-1+' short-term ratings.

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

Outlook

The outlook revision reflects the increased risk of deteriorating budgetary performance in combination with increasing debt levels. We believe that the city's budgetary performance could experience pressure in 2021-2022 as a result of demographic factors, together with lower tax revenues because of COVID-19. We expect debt to continue to increase as investment needs will remain high through 2022, stemming from Västerås' population growing materially faster than the national average.

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Downside scenario

We could lower the rating if these risks materialize and the city's management fails to utilize its fiscal flexibility to maintain budgetary discipline, leading to persistent operating balance deficits. In such a scenario, we might reevaluate our assessment on management and fiscal flexibility. We could also lower the ratings if long-term systemic support to the Swedish local government sector remains insufficient.

Upside scenario

The rating could stabilize at the current level if the downside risks are offset by additional central government support or management actions.

Rationale

We expect Västerås' management will remain committed to its financial goals despite pressure on the municipality's budgetary performance stemming from COVID-19, changes to the equalization system, and long-term demographic cost pressures. We believe Västerås has the scope to use its fiscal flexibility, for example by curbing expenditures, selling off assets, and adjusting the tax rate. We also expect investment needs to remain high through 2022, resulting in a continued build-up of debt in our forecasting period. We also believe management will uphold the conservative and prudent financial policies that underpin the municipality's strong liquidity position.

A stable institutional framework and experienced management team support the municipality's fiscal position

The institutional framework forms a key component of our ratings on Swedish LRGs. The system is supported by a far-reaching equalization system that evens out differences in wealth between municipalities and regions, and full autonomy over the local tax rate. The framework also displays a high degree of institutional stability and transparency, in part because the balanced budget requirement supports financial stability in the LRG sector. Even though the framework has no penalties for noncompliance, the requirement gives LRGs an incentive to maintain sound budgetary discipline and strict cost control.

That said, the sector's performance is deteriorating because LRGs are neither receiving adequate compensation from the central government nor implementing countermeasures sufficient to offset their increasing expenditure. Consequently, we now see a weakening trend for the institutional framework, rather than stable.

We consider Västerås' financial management to be competent and prudent, demonstrated by effective cost controls and sound debt and liquidity management. We also note that communication between civil servants and politicians is efficient and transparent, leading to high flexibility within the municipal organization. Furthermore, we have not observed any material changes in financial strategies since the new majority coalition came into effect after the 2018 election, pointing to a continued stable political landscape characterized by broad consensus on key priorities. On the other hand, debt has been building up over the past few years, which we believe is mainly related to investments in its company sector. Our base case assumes management will respond to any further budgetary pressures using its fiscal flexibility.

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In our view, Västerås' local economy is moderately strong, in a national comparison, with a larger share of engineering and technology-focused industries, leading to higher income levels than that of the national average, good infrastructure, and a rapidly increasing population.

Higher-than-national-average unemployment reflects an influx of jobseekers, rather than socioeconomic pressure. Västerås' economic position is supported by Sweden's stable and wealthy economy--we estimate GDP per capita at \$48,000 in 2020.

Continued strong budgetary discipline is key to mitigating pressures on budgetary performance and rising debt

We expect Västerås' budgetary performance will weaken slightly over the forecast horizon as a result of slower tax revenue growth and social welfare spending pressures. The central government is providing grants to cover for budgetary pressures related to COVID-19 and we believe that it will largely cover the impact in 2020. However, government grants are expected to be lower in 2021 and 2022, not fully compensating for shortfalls in tax revenues.

Changes to the equalization system, being introduced this year, are also negatively affecting Västerås' budgetary performance. To mitigate this, the central government will provide compensation grants for the first three years, which will gradually decrease every year. We also anticipate further pressure on operating expenditure due to demographic factors. However, in light of these upcoming challenges we expect Västerås' management will respond with active counterbalancing measures. Consequently, we believe that operating balance margins will weaken slightly but remain in balance throughout 2021-2022. We forecast an average operating balance of 3.5% over 2021-2022, compared with 4.3% in 2019-2020. Furthermore, we expect investments will remain high throughout the forecast period, largely in line with our previous base case.

Västerås operates a centralized in-house bank and onlends a majority of the debt to its company sector--the largest borrower being the housing company Bostads AB Mimer. In our view, Bostads AB Mimer is financially strong, can service its own debt in a timely manner, and does not require financial support from the municipality. Consequently, we believe onlending to the housing company mitigates Västerås' debt burden. Västerås has also stated its willingness to divest assets and has a track record of doing so. The proceeds from these divestments could be and have been used to repay debt.

Västerås has ongoing high investment needs of about SEK1 billion a year on average to accommodate the growing population and the changing demographic structure, with increasing proportions of children and the elderly. Similarly, the company sector requires about SEK600 million on average in onlending over the forecast horizon. We project Västerås' direct debt will reach 125% of adjusted operating revenue by year-end 2022, up from 100% in 2019.

Västerås' liquidity position remains very strong, supported by a diversified mix of liquidity sources including cash, contracted facilities, and financial assets. We calculate that Västerås' liquidity sources cover 171% of the upcoming 12 months of debt service, compared with 164% in our previous review. In our view, the city treasury is committed to prudent and risk-minimizing policies that will help maintain the coverage ratio comfortably over 120%. Furthermore, in line with other LRGs we rate in Sweden, we believe Västerås benefits from strong and reliable access to external liquidity.

Environmental, social, and governance (ESG) factors relevant to the rating action:

- Health and safety

Key Statistics

Table 1

Västerås Selected Indicators

SEK mil.	year ended Dec. 31					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenues	10,031	10,424	10,854	11,018	11,105	11,348
Operating expenditures	9,403	10,002	10,377	10,544	10,735	10,928
Operating balance	628	422	477	474	370	420
Operating balance (% of operating revenues)	6.3	4.0	4.4	4.3	3.3	3.7
Capital revenues	170	218	493	200	200	200
Capital expenditures	600	977	1,138	1,148	1,070	1,018
Balance after capital accounts	198	(337)	(168)	(474)	(500)	(398)
Balance after capital accounts (% of total revenues)	1.9	(3.2)	(1.5)	(4.2)	(4.4)	(3.4)
Debt repaid	4,582	3,962	2,453	3,630	2,650	3,300
Gross borrowings	4,843	4,178	3,748	5,185	3,672	4,085
Balance after borrowings	289	(92)	416	257	0	0
Direct debt (outstanding at year-end)	9,356	9,572	10,867	12,422	13,444	14,229
Direct debt (% of operating revenues)	93.3	91.8	100.1	112.7	121.1	125.4
Tax-supported debt (outstanding at year-end)	9,586	9,796	11,051	12,606	13,628	14,413
Tax-supported debt (% of consolidated operating revenues)	65.8	64.0	70.6	79.2	84.6	87.6
Interest (% of operating revenues)	0.9	0.7	1.0	1.1	1.1	1.1
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	462,329	477,635	491,337	465,130	492,961	512,985

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

Västerås Ratings Score Snapshot

Key rating factors	Score
Institutional framework	1
Economy	1
Financial management	1

Table 2

Västerås Ratings Score Snapshot (cont.)

Key rating factors	Score
Budgetary performance	2
Liquidity	1
Debt burden	3
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

- Sovereign Risk Indicators, April 24, 2020. An interactive version is available at <http://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

- COVID-19 Could Further Strain Swedish LRGs' Budgets, May 20, 2020
- Swedish Government To Mitigate Impact From Coronavirus On Local And Regional Governments, March 11, 2020
- Local Government Debt 2020: Low Growth And High Refinancing Are Fueling European Borrowing, March 2, 2020
- Sweden 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable, Feb. 14, 2020
- Public Finance System Overview: Swedish Municipalities And Regions, Dec. 3, 2019
- S&P Publishes 2020 Outlook For Local And Regional Governments Outside The U.S., Nov. 18, 2019
- 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

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- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019
- A Potential Profit Cap On Private Operators In Sweden's Welfare Sector Could Increase LRG Spending, March 11, 2019

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)

Nordic Regional Scale	--/--/K-1
Senior Unsecured	AAA
Commercial Paper	A-1+

Ratings Affirmed; Outlook Action

	To	From
Vasteras (City of)		
Issuer Credit Rating	AAA/Negative/A-1+	AAA/Stable/A-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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 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)

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