

Research Update:

City of Vasteras Outlook Revised To Stable From Negative; 'AAA/A-1+' Ratings Affirmed

June 3, 2022

Overview

- We expect the Swedish city of Västerås will post robust performance metrics through 2024 on the back of resilient tax revenue growth and continued budgetary discipline, despite economic turbulence and demographic-related cost pressure.
- Although we project sizable investment needs in the city, we believe management will remain committed to containing debt accumulation with a significant portion being lent on to its healthy company sector.
- We therefore revised our outlook to stable from negative and affirmed our 'AAA/A-1+' and 'K-1' ratings on Västerås.

Rating Action

On June 3, 2022, S&P Global Ratings revised its outlook on the Swedish city of Västerås to stable from negative and affirmed its 'AAA/A-1+' long- and short-term issuer credit ratings on the city. At the same time, we affirmed our 'K-1' Nordic regional scale rating on Västerås.

Outlook

The stable outlook reflects our view that Västerås' budgetary performance will remain robust despite fiscal pressure from gradually weaker macroeconomic fundamentals, declining central government support, and demographic issues characteristic of an aging population. At the same time, despite high investment needs both in the municipality and the company sector, we expect the city will remain committed to containing the debt burden and upholding the very strong liquidity position, which is underpinned by conservative financial policies.

Downside scenario

We could lower the rating if management fails to use its fiscal flexibility to mitigate pressure on budgetary performance, resulting in weaker budgetary results that are insufficient to maintain a

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robust financial position.

Rationale

We revised our outlook to stable from negative because we expect Västerås will counterbalance negative pressures on its operating results by remaining committed to budgetary discipline. We expect the city's management will take advantage of its fiscal flexibility to, for instance, contain expenditure growth, divest nonstrategic assets, and adjust its tax rate if needed. Consequently, despite macroeconomic and geopolitical turbulence, gradually declining central government support, and high investment needs, we expect Västerås will post resilient performance metrics through 2024. In addition, we project a moderate and manageable debt buildup, a significant share of which will be lent on to Västerås' healthy company sector, in particular the housing company Bostads AB Mimer.

Extensive central government support during the pandemic and planned initiatives have lessened the sectorwide risks that Swedish municipalities face

We consider the institutional framework in Sweden 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 is based on a far-reaching equalization system and tax autonomy. Since the outbreak of COVID-19, the central government has remained supportive of the LRG sector, implementing both direct and indirect support packages to boost operating performance for Swedish LRGs. Although structural challenges remain and budgetary performance could weaken somewhat as extraordinary support is phased out, we regard the risk of a significant deterioration of the sector's financial stability as limited. Consequently, we see the trend on the institutional framework assessment for Swedish municipalities and counties as stable (see "Institutional Framework Assessment: Swedish Municipalities And Counties," published Dec. 13, 2021, on RatingsDirect).

In our view, Västerås' financial management is competent, supported by a track record of strict cost control, along with sound debt and liquidity management. As a result, in our base-case scenario, we assume that management will respond to any budgetary pressures by using its budgetary flexibility--for example, by raising its tax rate, divesting assets, or moderating expenditure--to maintain robust performance metrics. At the same time, we believe the company sector is efficiently run, underpinned by clear strategic and financial targets. Also, the communication between civil servants and politicians is fluent and transparent, leading to high flexibility within the organization. Furthermore, we believe there is broad consensus on key priorities among political parties, underpinning the relatively stable political landscape in Västerås. The city has a history of forming strong majority coalitions, including parties from both sides of the political spectrum, resulting in a stable decision-making environment.

We consider the local economy in Västerås strong in a national comparison. The city's labor market is dominated by a large share of engineering and technology-focused industries, leading to higher income levels than the national average. In our view, the city's higher unemployment than the national average reflects an influx of jobseekers, rather than socioeconomic vulnerability. In addition, Västerås' economic position is supported by Sweden's strong economic fundamentals, demonstrated by an estimated GDP per capita of about \$60,900 in 2022.

Resilient tax revenue growth and budgetary discipline will help Västerås uphold a robust fiscal position while navigating macroeconomic turbulence

Because of continued central government support and strong tax revenue growth, reflecting the relatively speedy economic recovery in Sweden, Västerås reported very strong operating results in 2021. At the same time, throughout the pandemic, the demand for municipal services has been lower in some budgetary units, leading to lower-than-expected operating expenditure growth. Furthermore, since the outbreak of COVID-19, management has maintained a high level of preparedness and worked actively to cut costs on less pressing products and services.

For 2022-2024, we expect the decline in government grants, continued demographic pressure, and weaker macroeconomic fundamentals will gradually weaken budgetary performance to a more structurally sustainable level. As the pandemic abates, we also expect a return to more normal demand for municipal services, resulting in higher operating expenditure growth, especially in some city boards. That said, we expect tax revenue growth will remain resilient, counterbalancing these and any spillover effects from the conflict in Ukraine. Moreover, we expect Västerås will remain committed to budgetary discipline and internal surplus targets, while continuing to post positive structurally balanced budgets. Still, we expect the city's operating balances will gradually deteriorate below 5% of operating revenue in 2023-2024, in line with pre-pandemic levels.

We think the Russia-Ukraine conflict could have an impact on Swedish LRGs' budgetary trajectory throughout our forecast period (2022-2024). We believe it is possible that Swedish cities might receive an influx of refugees. That said, so far, the number of refugees coming to the city is limited. However, should the conflict lead to notable and permanent immigration to Västerås, it could spur additional capital spending and result in increased deficits after capital accounts for the city. We believe the central government will remain supportive and compensate most of the sector's additional costs, similar to its response to the 2015 European refugee crisis.

We forecast Västerås' capital expenditure will remain elevated throughout the forecast period. The substantial investment needs reflect the city's growing population and changing demographic structure, characterized by a larger share of children and elderly citizens. Consequently, a considerable portion of upcoming investments relates to the construction and refurbishment of schools and nursing homes. The largest single project concerns the development of the city district Mälarporten, including the construction of a new travel center.

In our view, Västerås has above-average flexibility to counteract pressure on its budgetary performance. The city benefits from its strong per capita tax base and comparably low tax rate, which sits below both the national and regional averages. Furthermore, Västerås has declared its willingness to divest nonstrategic assets, the proceeds from which can and have been used to repay debt. The city has a track record of carrying out such sales when required. Consequently, we believe Västerås enjoys considerable headroom to boost revenue if needed to support financial sustainability.

Västerås operates a centralized in-house bank and lends the majority of debt to its company sector, the largest recipient of funding being housing company Bostads AB Mimer. In our view, the company is financially robust, supported by a low-risk business profile and high demand for housing in Västerås, leading to non-cyclical and stable operating cash flows. As a result, we believe the company will service its debt in a timely manner, and not require financial support from the city, even in times of financial stress. Since the outbreak of COVID-19, the company has maintained a strong financial position while reporting stable operating cash flows. Consequently, we consider the lending to the housing company a mitigating factor to our assessment of

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Västerås' debt burden. If we adjust for this on-lending, the direct debt ratio in 2024 falls to 59%. Furthermore, we view the city's exposure to contingent liabilities as limited and unlikely to materialize.

The city's liquidity remains very strong, supported by a healthy mix of sources including cash, checking accounts, contracted facilities, and financial assets. In line with our criteria, we apply haircuts on the financial assets--which are managed in the form of mutual funds--based on underlying credit quality in the security holdings. Furthermore, the city's management has recently lengthened the maturity profile of its debt portfolio by reducing the volume of commercial paper, mitigating pressure on current and upcoming liquidity ratios. We estimate the debt service coverage ratio at 176%. The city treasury has a strong track record of maintaining ample liquidity buffers and keeping the coverage ratio comfortably above 120%. Furthermore, in line with other LRGs we rate in Sweden, we believe Västerås benefits from strong and reliable access to external liquidity, even in times of financial stress. Despite the initial capital market turbulence precipitated by the pandemic, the rated Swedish LRGs have enjoyed reliable access to external funding, supporting our view.

Key Statistics

Table 1

City of Vasteras--Selected Indicators

Mil. SEK	--Fiscal year ending Dec. 31--					
	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenues	10,854	11,460	11,578	11,592	11,938	12,375
Operating expenditures	10,377	10,675	10,506	10,990	11,395	11,820
Operating balance	477	785	1,072	602	543	554
Operating balance (% of operating revenues)	4.4	6.8	9.3	5.2	4.5	4.5
Capital revenues	493	139	599	90	200	200
Capital expenditures	1,138	1,237	1,222	1,241	1,518	1,514
Balance after capital accounts	(168)	(313)	449	(549)	(774)	(760)
Balance after capital accounts (% of total revenues)	(1.5)	(2.7)	3.7	(4.7)	(6.4)	(6.0)
Debt repaid	2,453	3,630	2,755	2,031	2,509	2,829
Gross borrowings	3,748	4,165	2,772	2,987	3,639	4,239
Balance after borrowings	416	(112)	(731)	0	0	0
Direct debt (outstanding at year-end)	10,867	11,402	11,419	12,376	13,506	14,916
Direct debt (% of operating revenues)	100.1	99.5	98.6	106.8	113.1	120.5
Tax-supported debt (outstanding at year-end)	11,051	11,585	11,597	12,548	13,674	15,079
Tax-supported debt (% of consolidated operating revenues)	70.9	72.7	69.3	76.5	81.0	86.5
Interest (% of operating revenues)	0.9	0.7	1.2	0.8	0.8	0.9
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A

Table 1

City of Vasteras--Selected Indicators (cont.)

Mil. SEK	--Fiscal year ending Dec. 31--					
	2019	2020	2021	2022bc	2023bc	2024bc
National GDP per capita (single units)	493,600	482,907	518,461	552,715	570,751	587,641

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

Ratings Score Snapshot

Table 2

City of Vasteras--Ratings Score Snapshot

Key rating factors	Score
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

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

- Sweden, May 2, 2022

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
- 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

- Institutional Framework Assessments For International Local And Regional Governments, May 18, 2022
- Local And Regional Governments Outlook 2022: Long-Term Challenges Resurface As The Pandemic Eases, Feb. 3, 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; Outlook Action

	To	From
Vasteras (City of)		
Issuer Credit Rating	AAA/Stable/A-1+	AAA/Negative/A-1+

Ratings Affirmed

Vasteras (City of)	
Issuer Credit Rating	
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AAA
Commercial Paper	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

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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/sourceId/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) 69-33-999-225; or Stockholm (46) 8-440-5914

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