

Research Update:

Region of Stockholm 'AA+/A-1+' Ratings Affirmed; Outlook Stable

April 2, 2021

Overview

- Continued central government support will support the Region of Stockholm's budgetary performance through 2023, despite lingering effects from the pandemic.
- Because of strong cash flow, we expect the region's debt metrics will gradually improve throughout the forecast period.
- We are therefore affirming our 'AA+/A-1+' global scale and 'K-1' regional scale ratings on the Region of Stockholm.
- The outlook remains stable.

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Rating Action

On April 2, 2021, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term global scale issuer credit ratings on Sweden's Region of Stockholm. The outlook is stable.

At the same time, we affirmed our 'K-1' short-term Nordic regional scale rating on the region.

Outlook

The stable outlook reflects our view that the Region of Stockholm will counteract budgetary pressure stemming from the COVID-19 pandemic, and that the central government will continue providing financial support. Furthermore, we expect the region's strong cash flow will result in gradually improved tax-supported debt ratios through 2023. At the same time, we expect the region's experienced financial management can maintain a strong liquidity position.

Downside scenario

We could lower the ratings if the region's management fails to contain operating expenditure, leading to a substantial deterioration of budgetary performance. In this scenario, we would also expect the region's liquidity and debt positions to weaken. Furthermore, we could take a negative

rating action if medium-term systemic support to the local and regional government (LRG) sector proves insufficient.

Upside scenario

We could consider a positive rating action if management's budgetary discipline improves further, leading to structural surpluses after capital accounts.

Rationale

Despite the financial impact of COVID-19 and changes to the cost equalization system, we expect the Region of Stockholm will post relatively stable operating balances through 2023. Its performance metrics will be supported by additional transfers from the central government to compensate for the pandemic's impact, notably extraordinary health care expenditure and revenue shortfalls related to public transportation. Furthermore, despite high investment needs, we expect the region's strong cash flow will result in gradually improved debt metrics. We forecast the region's debt will decrease, with tax-supported debt falling to 51% of consolidated revenue in 2023.

The central government has proved supportive during the COVID-19 pandemic but structural issues in the sector remain unresolved

We consider the institutional framework in Sweden to be extremely predictable and supportive. In our view, the framework displays a high degree of stability, and LRG sector's revenue and expenditure management is 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 sector, supports our view.

However, before the outbreak of COVID-19, the sector's budgetary performance had structurally deteriorated due to increasing expenditure, accentuated by central government policymaking, insufficient compensation mechanisms, and LRGs' inadequate countermeasures. Moreover, how the central government aims to address the sector's demographic challenges, and to what extent it should provide financial support, are unclear. Consequently, we assess the institutional framework as weakening.

Apart from a few management-related issues in the past, we regard the region's management as competent. The region's management adheres to strict budget discipline, demonstrated by a strong track record of balanced budgets. Furthermore, we believe that management will remain committed to prudent and risk-minimizing financial policies. Politically, the region remains stable since the majority center-right coalition continues its focus on combatting the impact of COVID-19, improving health care standards, addressing demographic issues, and expanding transport infrastructure to accommodate the region's growing population.

The Region of Stockholm benefits from Sweden's robust economic fundamentals, demonstrated by our estimate of GDP per capita at \$59,700 in 2021. The region's economy is strong, supported by a well-diversified labor market and high incomes, signaling its importance as a national and regional growth center. Although the pandemic has hit Stockholm hard, resulting in higher unemployment, we consider the region's structural economic fundamentals to be strong.

Government support will mitigate pressure on operating performance and debt metrics continue to decrease

Despite the adverse economic effects from the pandemic and changes to the cost equalization system, we expect the Region of Stockholm will post relatively stable operating balances through 2023, albeit weaker than the abnormally strong bottom-line result in 2020. Since COVID-19 started spreading in Sweden, the central government has implemented unprecedented support packages to the LRG sector, and provided extensive support to the private sector through employment schemes, shielding tax revenue growth. In addition, the region's strong result in 2020 is also attributable to extraordinary effects from asset sales and lower pension expenses due to a revised calculation of the pension liability. Because of the inflated earnings in 2020, the region made a provision to the profit equalization reserve that it can use to counterbalance weak results and comply with the balanced budget requirement.

In 2021-2023, we expect lingering effects from the pandemic will pressure operating performance. The region's prioritization of COVID-19 patients has caused nonemergency surgeries and other medical treatments to be postponed. Consequently, the region has accumulated a health care backlog that will require significant time and resources to reduce. In addition, the region will remain adversely affected by changes to the cost equalization system that took effect in 2020, since its annual contributions to the system will increase. The temporary annual implementation grant will decrease gradually and stop in 2023. On the other hand, we expect management will remain committed to the planned efficiency measures. Overall, we project relatively stable operating balances in the coming years, comfortably above 5% of operating revenue.

We expect the region's investment needs will remain high, leading to high capital expenditure throughout the forecast period. One major infrastructure project concerns the extension of the underground railway system, which will improve commuting options for residents of the greater Stockholm area. The capital expenditure related to this project will be cofinanced by the municipalities through which the underground lines will traverse. To account for potential delays in the region's investment plan, we apply a haircut of 25% to the budgeted figures. Furthermore, the region recently reached an agreement to sell a former hospital building, including the surrounding land.

In assessing the region's budgetary performance, we regard financial flexibility as below average. Similar to other Swedish health care regions, Stockholm employs a higher share of high-income earners, leading to larger annual pension costs than for the municipalities. In our view, these pension payments can crowd out other expenditures and require additional revenue to comply with the balanced budget requirement.

Given our base-case expectations of continued strong operating cash flows and haircut on capital expenditure, we forecast the region's tax-supported debt will decrease to 51% of consolidated revenue in 2023 from 57% in 2020. This trend also reflects gradually decreasing debt related to the public-private partnership project regarding the Nya Karolinska Solna hospital. Furthermore, since we assess the Region of Stockholm on a consolidated basis, our analysis incorporates the debt of the region's subsidiaries, including transport company AB Storstockholms Lokaltrafik. We consider exposure to financial leases to be the primary component of the region's contingent liabilities. These leases could result in future losses but we currently view risks as limited. Furthermore, the exposure as a share of consolidated revenue is negligible.

We regard the Region of Stockholm's liquidity position as very strong, supported by ample liquidity sources, including cash holdings and committed facilities. We estimate the weighted debt-service coverage ratio at 177%, despite high maturing debt in 2021 and 2022. We expect the region will

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maintain its long-term debt maturity structure and strong liquidity position through 2023. Furthermore, the region has a strong track record of reliable access to external financing, including bonds, commercial paper, and funding from the European Investment Bank. Overall, we consider the region's debt and liquidity management to be sophisticated, underpinned by prudent and risk-minimizing financial policies.

Key Statistics

Table 1

Region of Stockholm Selected Indicators

Mil. SEK	--Fiscal year end Dec. 31--					
	2018	2019	2020e	2021bc	2022bc	2023bc
Operating revenues	101,749	106,522	113,512	110,839	113,664	116,546
Operating expenditures	94,357	96,130	102,307	102,636	105,597	108,320
Operating balance	7,392	10,392	11,205	8,203	8,067	8,226
Operating balance (% of operating revenues)	7.3	9.8	9.9	7.4	7.1	7.1
Capital revenues	2,385	1,906	1,954	5,169	3,502	3,583
Capital expenditures	12,211	12,093	10,916	10,541	12,370	12,015
Balance after capital accounts	(2,434)	205	2,243	2,831	(801)	(206)
Balance after capital accounts (% of total revenues)	(2.3)	0.2	1.9	2.4	(0.7)	(0.2)
Debt repaid	5,977	6,219	9,200	8,229	8,318	3,366
Gross borrowings	8,296	7,292	7,024	3,386	9,119	3,572
Balance after borrowings	(89)	1,491	627	(2,012)	(0)	(0)
Direct debt (outstanding at year-end)	64,219	65,018	62,499	57,280	57,669	57,427
Direct debt (% of operating revenues)	63.1	61.0	55.1	51.7	50.7	49.3
Tax-supported debt (outstanding at year-end)	65,076	66,106	64,143	58,973	59,413	59,223
Tax-supported debt (% of consolidated operating revenues)	64.0	62.1	56.5	53.2	52.3	50.8
Interest (% of operating revenues)	1.4	1.2	1.3	1.3	1.3	1.3
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	477,094	491,200	479,449	497,941	518,171	537,124

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. e--Estimate. SEK--Swedish krona. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Region of Stockholm Ratings Score Snapshot

Key rating factors	Score
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	2
Stand-alone credit profile	aa+
Issuer credit rating	AA+

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 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 12, 2021

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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Feb. 8, 2021
- Extra Funding In Sweden's 2021 Budget Will Support LRGs, Sept. 24, 2020
- European Local And Regional Government Risk Indicators, June 30, 2020
- COVID-19: Fiscal Response Will Lift Local And Regional Government Borrowing To Record High, June 9, 2020
- 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
- Public Finance System Overview: Swedish Municipalities And Regions, Dec. 3, 2019

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- Sweden's Local Governments To Get A Slight Boost From 2020 Budget, Sept. 20, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 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

Stockholm (Region of)

Issuer Credit Rating	AA+/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AA+
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.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/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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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