

Research Update:

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

October 4, 2019

## Overview

- Through 2021, we expect the Region of Stockholm (formerly Stockholm County Council) to post strong, if declining, operating balances and make further investments, at a somewhat reduced level, leading to contained deficits after capital expenditure (capex).
- We now forecast that the region's tax-supported debt will peak at 66% of revenue this year and then gradually decrease.
- 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.

## Rating Action

On Oct. 4, 2019, 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 indicates that we expect the region's weakened operating balances to be mitigated by lower capex so that performance metrics will deteriorate only slightly in 2019-2021. Our base-case scenario for 2019-2021 assumes that the region's tax-supported debt will gradually trend down, and we anticipate continued prudent liquidity management to support the region's exceptionally strong liquidity position.

## Downside scenario

If the region's budgetary performance is weaker than we assume in our base case and investments are higher than expected, the deficit after capex could fall below 5% of revenue.

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Combined with the region's liquidity coverage ratio structurally falling below 120%, this could cause us to lower our assessment of both the region's budgetary performance and its liquidity, and to lower the rating.

### **Upside scenario**

We could raise the rating if budgetary performance improves, so that there is a positive balance after capex and tax-supported debt decreases sustainably below 60% of revenue.

### **Rationale**

In our view, the region's operating balances will remain strong, but will decline through 2021, and it will continue its ambitious investment program, although at a somewhat reduced level. As a result, deficits after capex will be contained.

The region's very strong local economy, liquidity position, and Sweden's institutional framework for local and regional governments (LRGs) are pronounced rating strengths that offset factors like its debt burden, pension liabilities, and structural expenditure pressure.

### **Sweden's institutional framework and the region's strong local economy support the rating**

Since the September 2018 election in the Region of Stockholm, it has been governed by a majority center-right coalition and the Green Party. The coalition comprises the Moderate Party, Liberal Party, Center Party, and Christian Democrats. To date, these parties have cooperated well together and we expect them to continue to focus on improving health care standards, solving demographic issues, and expanding the transportation infrastructure to accommodate the region's growing population.

The region has some legacy management-related issues that could have spillover effects, such as in financial leases and the public-private project to develop, build, maintain, and finance New Karolinska Solna University Hospital. Despite this, we view the region's financial management as competent and we expect it to use its financial flexibilities to counteract budgetary pressure.

The Region of Stockholm is a net contributor to the Swedish LRG equalization system. We consider the institutional framework extremely predictable and supportive to the whole sector, and it is a key component of our rating on the region. In our view, the system displays a high degree of institutional stability and the sector has good means for strong revenue and expenditure balance, given the far-reaching equalization system and LRGs' autonomy in setting local or regional tax rates.

The Region of Stockholm's economy is well balanced. It has a diverse industry structure and high income levels, signaling its importance as a national and regional growth center. However, because the comprehensive equalization system evens out wealth levels among LRGs, we use the national GDP per capita of approximately Swedish krona (SEK) 485,433 (about \$53,300) as the starting point for our analysis. Population growth in the region is strong, averaging 1.65% over the past three years, compared with the national average of 1.2%. Furthermore, at 6.0% in August 2019, unemployment is marginally lower than the national average of 6.9%.

## Planned changes to the equalization system are likely to weaken budgetary performance

The region has a track record of robust budgetary performance--its operating balances averaged 8.9% of operating revenue in 2016-2018. Tax revenue growth in 2019 is likely to remain strong, but be somewhat lower than in previous years. Budgetary planning will remain constrained by structural deficits at several of the region's hospitals. Our base case still assumes that the region will narrow deficits at some of these hospitals by gradually improving its budgetary steering.

The Swedish central government's planned amendments to the LRG sector's equalization system are expected to take effect in 2020. The proposed changes aim to further compensate for and even out the structural cost differences that have evolved from differences in demography, geography, or socioeconomic factors. The Region of Stockholm is one of the LRGs most negatively affected by the proposed changes.

Our base case now incorporates the preliminary numbers, making it weaker than the base case we used in our last review by SEK574 million in 2020 and SEK1149 million in 2021. Under our new base case, we assume a five-year operating margin average of 7.46%, compared with 8.09% at our previous review.

We project that the region's capex will peak in 2019 and decline in the two years thereafter. In addition, we expect investments will be slightly lower than the region's budgeted figures. Consequently, we expect investment to average a high 12.1% of total expenditure throughout 2019-2021.

In assessing the region's budgetary performance, we regard financial flexibility as below average because, like the other Swedish health-care regions, the Region of Stockholm has to cater for increased pension payments. These increasing payments can limit the financing of operations and capex.

Now that we have updated our forecast for budgetary performance and investments, we predict that the region's tax-supported debt will amount to 63.6% of consolidated revenue by 2021, down slightly from 63.9% in 2018. Tax-supported debt includes financial leases and our estimate of the present value of capital and funding costs from the public-private partnership agreement for New Karolinska Hospital. Given that we assess Region of Stockholm on a consolidated basis, our analysis automatically includes transport company AB Storstockholms Lokaltrafik, and all other subsidiaries' debt and income statement items. We consider the ongoing financial leases to be the source of the region's major remaining contingent liability. These leases could lead to potential future losses and recapitalization; although we do not view these as negligible, we do consider them to be contained.

Region of Stockholm's liquidity positions have historically been exceptionally strong, in our view. It has a track record of reliable access to external liquidity and funding and a comprehensive set of committed loan facilities. We estimate that its weighted debt service coverage ratio is 116%, based on predicted cash balances averaging Swedish krona (SEK) 2 billion, committed bank lines of SEK3 billion, and a checking account balance of SEK3 billion. The region also has loan agreements with the European Investment Bank (EIB) linked to specific infrastructure investment plans. We include the SEK4.375 billion available under the EIB loans as a liquidity source. Even if the region has buffered additional liquidity, the liquidity cover ratio has weakened since our last review because we have changed our calculation method. The region is, in our view, committed to prudent and risk-minimizing policies, which leads us to expect it will improve the cover ratio structurally above 120% of upcoming debt service.

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Region of Stockholm has a range of funding alternatives, which reduces refinancing risk. Funding is largely acquired through a €4 billion euro medium-term note program. The region also has a SEK5 billion commercial paper program. Overall, we consider the region's debt management to be prudent. Our base-case assumption is that the region will maintain its long-term loan portfolio and that its liquidity will remain exceptionally strong over 2019-2021.

## Key Statistics

Table 1

### Region of Stockholm Selected Indicators

(MIL. SEK)	--Year ended Dec. 31--					
	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	92,245	97,259	101,749	105,574	108,503	111,691
Operating expenditures	85,674	87,794	94,331	98,789	101,254	103,669
Operating balance	6,571	9,465	7,418	6,785	7,249	8,022
Operating balance (% of operating revenues)	7.1	9.7	7.3	6.4	6.7	7.2
Capital revenues	800	257	735	200	200	200
Capital expenditures	13,514	13,860	12,211	14,153	13,103	12,489
Balance after capital accounts	(6,143)	(4,138)	(4,058)	(7,168)	(5,654)	(4,267)
Balance after capital accounts (% of total revenues)	(6.6)	(4.2)	(4.0)	(6.8)	(5.2)	(3.8)
Debt repaid	1,424	2,050	5,977	2,388	5,550	7,620
Gross borrowings	4,081	3,421	6,277	7,206	7,714	7,656
Balance after borrowings	(756)	(895)	(89)	106	0	0
Direct debt (outstanding at year-end)	59,207	60,660	64,219	68,725	70,545	70,205
Direct debt (% of operating revenues)	64.2	62.4	63.1	65.1	65.0	62.9
Tax-supported debt (outstanding at year-end)	59,761	61,484	65,076	69,582	71,402	71,062
Tax-supported debt (% of consolidated operating revenues)	64.8	63.2	64.0	65.9	65.8	63.6
Interest (% of operating revenues)	1.4	2.1	2.1	2.2	2.3	2.7
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	445,182	458,105	473,294	485,433	498,816	514,531

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. N/A--Not applicable.

## Ratings Score Snapshot

Table 2

## Region of Stockholm Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	3
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

- Summary: Sweden, Aug. 23, 2019

## 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

- 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
- Sovereign Risk Indicators, July 11, 2019. An interactive version is also available at [www.spratings.com/sri](http://www.spratings.com/sri)
- A Potential Profit Cap On Private Operators In Sweden's Welfare Sector Could Increase LRG Spending, March 11, 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,

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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

#### 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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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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