

Research Update:

Sweden's Region of Skane Upgraded To 'AAA' On Improved Budget Control; Outlook Stable

April 21, 2023

Overview

- The political situation in the region of Skåne has improved, compared with the political deadlock seen in 2014-2018, resulting in tighter financial management and improved compliance with Sweden's accrual-based balanced-budget requirements.
- Despite sectorwide headwinds related to inflation and a temporary rise in pension costs, we expect Skåne will remain committed to budgetary discipline and maintain structurally sound performance while containing debt growth.
- We are therefore upgrading Skåne to 'AAA' from 'AA+'. The outlook is stable.

Rating Action

On Apr. 21, 2023, S&P Global Ratings raised its long-term issuer credit rating on Sweden's region of Skåne to 'AAA' from 'AA+'. The outlook is stable.

Outlook

The outlook is stable because we anticipate that Skåne will maintain sound budgetary performance, supported by strict budgetary discipline and strong tax-revenue growth, and its debt burden will remain contained.

Downside scenario

We could consider a downgrade if Skåne's management loosens its grip on capital spending, leading to materially higher debt. We could also lower the rating if we observe less prudent reserve practices resulting in a structurally weaker liquidity position.

PRIMARY CREDIT ANALYST

Erik A Karlsson
Stockholm
+ 46(0)84405924
erik.karlsson
@spglobal.com

SECONDARY CONTACT

Carl Nynerod
Stockholm
+ 46 84 40 5919
carl.nynerod
@spglobal.com

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Rationale

The upgrade reflects our view that Skåne's financial management has tightened compared to some years ago. In combination with strong nominal tax growth, we expect the region's operating performance will remain strong. However, owing to its ambitious capital spending plans, we expect it will accumulate debt in the coming two years. We also expect Skåne will maintain its solid liquidity position.

Political stability and budget discipline support the region's performance

Skåne is governed by a right-leaning minority government through the current parliamentary period. The government is expected to receive passive support from the Sweden Democrats party on budget decisions, which we think will facilitate stable budget processes. We have observed consensus among the political parties on the region's long-term strategies, and we don't expect any major disruptions to the region's operations following the elections last year. Like other Swedish regions, we foresee pressure on Skåne's ability with the balanced budget requirement in 2023-2024, owing to a temporary increase in pension provisions. Positively, in our view, Skåne is addressing these sectorwide challenges prudently, as shown by its sustained strong operating performance and limited deficits after capital accounts.

Skåne benefits from Sweden's wealthy economy, where we estimate the national GDP per capita at about \$58,000 in 2023. Largely thanks to the fixed-link toll road between Malmö and Copenhagen, Skåne benefits from the increasing integration of the Swedish-Danish Oresund region, which supports its growth prospects and diversification. On the negative side, unemployment in the region is higher than the national average.

We assess Sweden's institutional framework as extremely predictable and supportive. In our view, the framework displays a high degree of stability, and the sector's revenue and expenditure management are based on a far-reaching equalization system and tax autonomy. Since the start of the COVID-19 pandemic, the central government has remained supportive of the local and regional governments (LRGs), implementing both direct and indirect support packages to boost the operating performance of Swedish municipalities.

Robust tax revenue growth combined with budgetary discipline should mitigate pressure on operating performance

We expect Skåne will post sound operating performance through 2025, although at somewhat weaker levels than during the years it received pandemic-related financial support. Operating spending will increase substantially in the next two years. This is due, for instance, to rising employee costs, which amount to more than 50% of the region's operating spending; and catch up on noncritical health care spending that was postponed during the pandemic. Pension costs will also rise, partly because of a new pension agreement that increases the region's annual contributions from 2023. We think Skåne will enhance its cost control to mitigate the impact of these pressures. At the same time, we estimate nominal tax-revenue growth will remain strong in the next two years. We also think the use of public transport will continue to recover, contributing positively to budgetary performance.

Under Sweden's decentralized health care system, we continue to regard Skåne as having relatively weaker budgetary flexibility than for instance Swedish municipalities. Due to the nature of the regions' responsibilities, which results in higher salaries, they have a larger pension liability

compared to municipalities. In addition to the new pension agreement, the LRG sector's pension liability is inflation adjusted, resulting in significantly higher noncash provisions in 2023-2024. Together, this will have an adverse effect on LRGs' financials, although we expect the impact will be larger for the regions, including Skåne. Although noncash items are not part of our operating balance calculation, it is included in Sweden's compulsory balanced-budget requirement, and we think it's likely that Skåne will post balanced budget deficits in 2023 and possibly 2024. We note that Skåne has set aside about Swedish krona (SEK) 1 billion of non-cash reserves that can be used to bridge regulatory deficits. In addition, the Municipal Act allows LRGs to report negative balanced budget results, under special circumstances, without having to close the deficit.

We forecast Skåne will complete about SEK5.2 billion of capital spending annually through 2025, resulting in modest deficits after capital accounts. We think supply-chain issues and rising costs will slow project-completion rates. However, in the longer term, the region has large upcoming investments related to property maintenance, major rebuilds, upgrades of its four largest hospitals, and the sizable infrastructure of its public transport unit, Skånetrafiken. We believe these projects could become more expensive than planned and potentially push capital spending beyond our forecasts.

After reducing its debt in 2022, Skåne will likely increase its nominal debt in 2023-2025, in our view. That said, we forecast relatively minor net new borrowing needs, and expect the region's tax-supported debt to remain fairly stable at 15%-20% of consolidated revenue during that period. In addition to Skåne's own debt, we include extended guarantees up to about SEK1.2 billion into our calculation of tax-supported debt. The region's contingent liabilities, including extended commitments to public transportation, appears limited. Similar to its Swedish peers, Skåne has a relatively short-dated debt maturity profile, and we expect rising interest rates will have a relatively quick impact. However, owing to a low debt burden and interest rates rising from low levels, the overall impact on Skåne's financial position should be limited. We don't expect interest expenditure will exceed 0.5% of revenue.

We assess Skåne's liquidity position as exceptionally strong, supported by available cash and committed credit facilities covering 179% of debt service within one year. We expect the region to maintain its current debt maturity structure and maintain enough credit facilities to support its liquidity position. Skåne's liquidity position is further reinforced by the region's strong track record of access to external financing, including bonds, commercial paper, and funding from multilateral institutions. In our calculation, we include SEK4.9 billion of cash and committed and undrawn facilities, close to SEK400 million of estimated borrowing needs, and SEK2.7 billion of maturing loans and interest payments over the coming 12 months.

Key Statistics

Table 1

Region of Skane--Selected Indicators

Mil. SEK	--Fiscal year end Dec. 31--					
	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenues	56,355	59,293	62,818	64,611	67,277	69,731
Operating expenditures	52,705	54,237	58,032	60,224	62,791	64,915
Operating balance	3,650	5,056	4,786	4,387	4,487	4,816
Operating balance (% of operating revenues)	6.5	8.5	7.6	6.8	6.7	6.9

Table 1

Region of Skane--Selected Indicators (cont.)

Mil. SEK	--Fiscal year end Dec. 31--					
	2020	2021	2022	2023bc	2024bc	2025bc
Capital revenues	25	27	6	21	21	21
Capital expenditures	4,152	4,636	4,409	4,957	5,120	5,629
Balance after capital accounts	(477)	447	383	(549)	(612)	(793)
Balance after capital accounts (% of total revenues)	(0.8)	0.8	0.6	(0.8)	(0.9)	(1.1)
Debt repaid	1,344	1,246	1,062	2,929	1,778	1,510
Gross borrowings	2,814	1,882	0	3,250	2,464	2,250
Balance after borrowings	1,334	712	(1,121)	(228)	74	(53)
Direct debt (outstanding at year-end)	8,744	9,380	8,817	9,138	9,824	10,564
Direct debt (% of operating revenues)	15.5	15.8	14.0	14.1	14.6	15.1
Tax-supported debt (outstanding at year-end)	9,760	10,571	9,960	10,306	11,015	11,779
Tax-supported debt (% of consolidated operating revenues)	17.3	17.8	15.9	16.0	16.4	16.9
Interest (% of operating revenues)	0.1	0.1	0.1	0.3	0.3	0.5
Local GDP per capita (SEK)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (SEK)	487,872	526,244	566,987	598,376	622,440	642,470

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. SEK--Swedish krona.

Ratings Score Snapshot

Table 2

Region of Skane Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	1
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 10, 2023. An interactive version is available on www.spglobal.com/sri

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Risk management, culture, and oversight

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: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022
- Most Rated Swedish LRGs Can Absorb Higher Interest Costs, Sept. 12, 2022
- Southern Swedish LRGs Bear The Brunt Of Surging Electricity Prices, July 20, 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

Upgraded

	To	From
Region of Skane		
Issuer Credit Rating	AAA/Stable/--	AA+/Positive/--

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; or Stockholm (46) 8-440-5914

Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.