

Research Update:

# Swedish Municipality of Vellinge 'AA+/A-1+' And 'K-1' Ratings Affirmed; Outlook Stable

August 9, 2024

## Overview

- We expect the Municipality of Vellinge will uphold strong operating performance through 2026, on the back of robust tax revenue growth and gradually decreasing inflationary cost pressure.
- Vellinge's investment and borrowing needs will remain relatively high in 2024-2025, due to a peak in capital investment, before returning to more structurally sustainable levels thereafter, according to our base case.
- In addition, Vellinge's liquidity position should strengthen after 2024 thanks to lower debt repayments.
- We therefore affirmed our 'AA+/A-1+' and 'K-1' ratings on Vellinge. The outlook is stable.

## Rating Action

On Aug. 9, 2024, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the Municipality of Vellinge. The outlook is stable. At the same time, we affirmed our 'K-1' Nordic regional scale rating on Vellinge.

## Outlook

The stable outlook reflects our view that Vellinge's sound financial risk management and continued budgetary discipline will mitigate cost pressures. At the same time, we expect the municipality will sustain its strong operating performance and contain the debt burden despite sizable investment needs.

## Downside scenario

We could lower our ratings if management fails to adequately address demographic cost pressures and other budgetary issues, such as operational risks and elevated capital expenditure (capex), leading to structurally weaker budgetary performance. In such a scenario, the

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municipality's debt burden might increase more rapidly than we expect.

## **Upside scenario**

We could consider a positive rating action if Vellinge managed to put a dent in its debt burden while remaining committed to strict budgetary discipline alongside prudent financial, liquidity, and debt management.

## **Rationale**

We expect Vellinge's operating performance will gradually improve through 2026 on the back of decreased cost inflation and robust tax revenue growth. At the same time, we think Vellinge will remain committed to budgetary discipline and implement efficiency measures to meet internal surplus targets and uphold a sound financial position. However, the municipality's cash flows after investments will be subdued in 2024-2025, due to a temporary peak, albeit unusually high, in capex. Moreover, the liquidity position is set to improve as debt repayments decrease from abnormally elevated levels in 2024.

## **An extremely supportive institutional framework and robust demographic fundamentals continue to underpin the ratings**

We consider the institutional framework in Sweden 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. Historically, the central government has provided extensive support to the local and regional government (LRG) sector, for example through additional grants distributed in response to the pandemic or more recently to cover rising pension costs (for more information, see "Institutional Framework Assessment: Swedish Municipalities And Regions Have Flexibility To Balance Costs," published Nov. 29, 2023, on RatingsDirect).

The political landscape in Vellinge has been stable for many years. The municipality is governed by the right-leaning Moderate Party. In our view, Vellinge displays a track record of conservative revenue and expenditure management, as its strong budgetary performance indicates. Furthermore, we think Vellinge has taken steps to strengthen its financial risk management.

We assume the cyberattack that affected Vellinge's operations has had limited financial impact on the municipality. The mid-January 2024 incident, when one of Vellinge's IT service providers was targeted, resulted in the shutdown of parts of the municipality's IT infrastructure. As a result, some day-to-day operations were temporarily carried out manually, and the city incurred related expenditure of Swedish krona (SEK) 8.5 million, as of March 2024. Although some uncertainty remains about the total added costs and to what extent the municipality will be covered indirectly by the IT service provider's insurance, overall, we do not expect the cyberattack to have a material impact on the municipality's finances.

Vellinge's favorable economic position is supported by high income levels, low unemployment, and close integration with the Öresund region, which constitutes the largest labor market in the Nordics. Vellinge also benefits from Sweden's robust economic fundamentals, reflected in our estimate of 2024 national GDP per capita of \$59,600.

## Strong tax revenue growth, eased inflationary cost pressure, and budgetary discipline should mitigate strain on Vellinge's performance metrics

Considering the municipality's strong operating performance in 2023, Vellinge's budgetary performance should gradually strengthen through 2026, according to our base case. In 2023, when the budget was announced, higher-than-expected expenditure growth highlighted inflationary pressures. However, the labor market remained robust despite macroeconomic headwinds, resulting in stronger tax revenue growth than anticipated.

In 2024, we expect cost inflation to continue putting pressure Vellinge's budgetary performance. Most importantly, a new pension agreement will impair operating results in the Swedish LRG sector. In addition, annual pension provisions will increase since these are indexed to inflation. Based on our inflation projections, we expect these provisions will remain elevated in 2024 before decreasing in 2025. However, these provisions do not generate cash outflows, meaning our calculated performance metrics are not affected (see "Sweden's Local And Regional Governments Have Less Room To Maneuver Over The Next Year As Pension Costs Rise," published Sept. 14, 2023).

For 2025-2026, we expect Vellinge's performance metrics will gradually improve as cost pressure abates and tax revenue growth remains robust. At the same time, although the average interest rate for the debt portfolio has increased, we foresee a gradual decrease in the cost of new borrowing through 2026. Also, given Vellinge's relatively low debt burden, we don't expect interest payments to materially affect the financial position. Moreover, we assume management will remain committed to budgetary discipline and adhere to the municipality's financial targets, translating into operating balances structurally above 5%.

We anticipate that Vellinge's capex will remain high through 2025. A notable share of the investment plan relates to the construction of two elementary schools. Capex will decrease notably in 2025 to more sustainable levels, however, since these large spending projects will have been completed. Nevertheless, population projections for Vellinge, despite the recent downward revision, suggest continued investment needs, albeit not at the same level as in 2024-2025. Consequently, we expect the municipality's deficit after capital accounts will stabilize at 0%-5% from 2026 on.

Furthermore, we anticipate limited investments and borrowing needs in the municipality's fully owned housing company, Vellingebostäder AB, through 2026. The other two municipal companies, Vellinge Kommunlokals AB and Vellinge Stadsnät AB, plan to continue amortizing debt according to plan. Overall, we expect a moderate increase in Vellinge's tax-supported debt through 2026, and primarily from investments in the municipality. In tax-supported debt, we also include guarantees extended to various associations and the holding company, Vellinge Koncern AB, because we consider the entity's activities closely tied to the municipality. Moreover, Vellinge's exposure to contingent liabilities is limited and we see the risk of materialization as low.

Vellinge's liquidity sources primarily include cash and financial assets the municipality's pension portfolio, to which we apply appropriate haircuts in line with the underlying credit quality. Thanks to favorable stock market developments, the market value of Vellinge's financial assets has increased notably so far in 2024. As a result, in line with the financial policies, Vellinge has divested a minor share of the assets and transferred the proceeds to cash holdings instead. After abnormally high debt repayments in 2024, maturing debt is set to decrease significantly in 2025-2026, yielding stronger liquidity ratios. Moreover, in our view, Vellinge benefits from strong and reliable access to external liquidity, even in times of financial stress.

## Key Statistics

Table 1

### Municipality of Vellinge--Selected Indicators

(Mil. SEK)	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenues	2,537	2,685	2,867	2,930	3,069	3,174
Operating expenditures	2,257	2,353	2,610	2,731	2,800	2,876
Operating balance	280	333	257	199	269	298
Operating balance (% of operating revenues)	11.0	12.4	9.0	6.8	8.8	9.4
Capital revenues	73	76	38	90	50	40
Capital expenditures	259	441	507	642	562	418
Balance after capital accounts	94	(32)	(212)	(353)	(243)	(80)
Balance after capital accounts (% of total revenues)	3.6	(1.2)	(7.3)	(11.7)	(7.8)	(2.5)
Debt repaid	600	300	550	800	250	300
Gross borrowings	400	400	850	1,200	450	400
Balance after borrowings	(218)	21	(56)	31	(24)	9
Direct debt (outstanding at year-end)	2,200	2,300	2,600	3,000	3,200	3,300
Direct debt (% of operating revenues)	86.7	85.7	90.7	102.4	104.3	104.0
Tax-supported debt (outstanding at year-end)	2,371	2,471	2,722	3,123	3,324	3,424
Tax-supported debt (% of consolidated operating revenues)	88.2	87.0	89.8	100.6	102.2	101.8
Interest (% of operating revenues)	0.4	0.5	1.5	2.4	2.8	3.0
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	526,517	561,139	589,840	605,836	626,891	647,406

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.

## Ratings Score Snapshot

Table 2

### Municipality of Vellinge--Ratings Score Snapshot

#### Key rating factors

Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	2

Table 2

## Municipality of Vellinge--Ratings Score Snapshot (cont.)

### Key rating factors

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

Sovereign Risk Indicators, July 8, 2024. An interactive version is available at <http://www.spratings.com/sri>.

## 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

- Nordic Public Finance Credit Outlook 2024: A Mixed Picture, May 16, 2024
- Institutional Framework Assessments For Local And Regional Governments Outside Of The U.S., April 8, 2024
- Subnational Debt 2024: Focus on Debt Sustainability, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Subnational Debt 2024: Global LRGs Can Handle Rising Interest Expenses, Feb. 29, 2024
- Institutional Framework Assessment: Swedish Municipalities And Regions Have Flexibility To Balance Costs, Nov. 29, 2023
- Sweden's Local And Regional Governments Have Less Room To Maneuver Over The Next Year As Pension Costs Rise, Sept. 14, 2023

In accordance with our relevant policies and procedures, the Rating Committee was composed of

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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

#### Vellinge (Municipality of)

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Issuer Credit Rating	AA+/Stable/A-1+
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Nordic Regional Scale	--/--/K-1
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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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers 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.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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