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Vastra Gotaland (Region of)

Primary Credit Analyst:

Gabriel Forss, Stockholm (46) 8-440-5933; gabriel_forss@standardandpoors.com

Secondary Credit Analyst:

Carl Nyreod, Stockholm (46) 8-440-5919; carl_nyreod@standardandpoors.com

Table Of Contents

Major Rating Factors

Rationale

Outlook

Comparative Analysis

System Support And Predictability

Economy

Management Capacity And Institutional Legitimacy

Financial Flexibility

Budgetary Performance

Liquidity And Debt Management

Debt Burden

Contingent Liabilities

Vastra Gotaland (Region of)

Major Rating Factors

Strengths:

- Very strong system support and institutional stability
- No direct debt
- Healthy liquidity position
- Sound financial performance

Weaknesses:

- Relatively high unfunded pension liabilities despite introduction of pension fund
- Exposure to ailing automotive sector putting pressure on economic structure

Issuer Credit Rating
AA+/Stable/A-1+
<i>Nordic National Scale Rating</i>
--/--/K-1

Rationale

The ratings on the Swedish Region of Västra Götaland reflect its continued sound financial performance, healthy liquidity, and lack of direct debt. Moreover, the strong system support and institutional stability of the Swedish local and regional government (LRG) system also support the ratings.

These strengths are offset by the region's large unfunded pension liabilities and a macroeconomic structure exposed to an ailing automotive industry.

Västra Götaland benefits from strong system support and institutional stability. A far-reaching equalization system and good compliance with the sector's balanced-budget requirement have made Sweden's LRG system one of the world's strongest. The state's long track record of support and commitment to stability compensate for the lack of formalized bail-out procedures.

Västra Götaland continued its sound, stable budgetary performance in 2007. Successful savings measures and improved expenditures helped stabilize the region's operating performance over the past years. August 2008 forecasts indicate that the operating balance will remain stable, at 4.0% of operating revenues, and the balance after investments will be essentially balanced for 2008.

Moreover, the region's 2009 budget and forecast budgets through 2011 indicate average operating balances at 3.0% of operating revenues. Over the same period accounts after investments are expected to be slightly on the negative side, averaging about negative 1.0%. Standard & Poor's Ratings Services expects the region to achieve its targets for 2008, with challenges arising in 2009 and onward. Continued cost containment will be required to combat falling tax revenues caused by the economic slowdown without having to resort to tax rate increases.

The local economy has shown increasing diversification in recent years. Nevertheless, a relatively high exposure to manufacturing--including an ailing automotive industry--exacerbated by current economic conditions, still remains. In October 2008, car-manufacturer Volvo (publ), AB (Volvo; --/--/A-2) announced layoffs of about 3,000 people in Västra Götaland. Likely further layoffs in supporting industries would significantly challenge unemployment levels in the coming years. However, the region's increasingly well-diversified local economy and central government actions to mitigate the automotive industry layoffs will probably limit downside risk stemming from the labor

market for the region's finances in the short term.

At year-end 2007, Västra Götaland had no direct debt. The region forecasts direct debt will remain at a very low level over the next few years. Nevertheless, Västra Götaland's unfunded pension liabilities equal 68% of revenues. Consequently, net financial liabilities (tax-supported debt plus unfunded pension liabilities, minus free cash and equivalents) were 61% of total revenues at year-end 2007.

Liquidity

Liquidity is strong. At year-end 2007, the region had cash and liquid short-term investments amounting to more than Swedish krona (SEK) 3 billion. These investments have been made very prudently and we found no material risk exposure in the investment portfolios. Moreover, additional liquidity is available with a checking account of SEK750 million, and further committed facilities amounting to SEK3 billion are available. These comprehensive liquidity reserves amounted to 19% of operating revenues at year-end 2007.

Outlook

The stable outlook reflects our expectation that Västra Götaland will register slightly weaker operating performance in the coming years, but that the region will nevertheless be able to prudently match expenditures to revenues and keep its direct debt low.

Significantly stronger-than-expected budgetary balances without large-scale tax increases, along with a decline in, or at least a stabilization of, net financial liabilities, may trigger a positive rating action.

Conversely, the ratings could come under pressure if the region was to register significant operating deficits, a material increase in debt ratios, or if the current layoffs would have a greater-than-expected effect on the region's finances.

Comparative Analysis

Overall, Västra Götaland's economy is becoming increasingly diversified, but is still carrying a high exposure to the manufacturing and automotive industries. The region's key indicators, such as age distribution, per capita tax base, and unemployment, are close to the national averages. The region's financial performance compares well with that of Swedish and international rated peers. Direct debt compares favorably with that of both Swedish and international peers, although net financial liabilities (including pension liabilities) are average compared with peers'.

Table 1

Region of Vastra Gotaland 2007 Peer Comparison				
	Vastra Gotaland (Region of)	Aragon (Autonomous Community of)	Stockholm County Council	Styria (State of)
Issuer credit rating	AA+/Stable/A-1+	AA+/Stable/--	AA+/Stable/A-1+	AA+/Stable/A-1+
National scale ratings	--/--	--/--	--/--/K-1	--/--
Three-year averages, using actual results only				
Operating balance (% of operating revenues)	6.0	17.6	5.8	(2.2)

Table 1

Region of Vastra Gotaland 2007 Peer Comparison(cont.)				
Balance after capital expenditures (% of total revenues)	2.2	(1.9)	(1.1)	(4.5)
Capital expenditures (% of total expenditures)	4.0	21.5	7.8	20.1
Transfers received (% of total revenues)	20.4	33.5	4.7	26.4
2007 (mil. €)				
Total revenues	4,386.9	4,021.5	7,022.8	4,231.0
Modifiable revenues (% of operating revenues)	79.0	40.4	94.7	6.0
Direct debt (at year-end)	10.1	1,136.0	2,040.2	567.3
Direct debt (% of operating revenues)	0.2	28.8	29.3	14.9
Tax supported debt (% of total revenues)	0.6	29.2	31.7	18.6
Net financial liabilities (% of tot rev)	60.8	25.1	81.9	81.5
Interest (% of operating revenues)	1.1	1.6	1.7	0.5
Debt service (% of total revenues)	1.1	3.5	4.0	0.6
Population	1,544,600	1,265,255.0*	1,949,516.0	1,202,196.0¶
Unemployment rate (%)	2.8	5.3	2.5	4.0*
GDP (nominal) per capita, unscaled	34,124.6*	25,640.3	46,954.5*	25,560.4¶

*Figures for 2006. ¶Figures for 2005. This ratio is calculated using Standard & Poor's estimates of unfunded pension liabilities for German states, Austrian states, and some Mexican states.

System Support And Predictability

The Swedish LRG system provides strong system support and institutional stability. It features a far-reaching equalization system, and gains good compliance from the sector with regard to the balanced-budget requirement. As a result, the Swedish LRG system is one of the strongest in the world. The comprehensive Swedish equalization system is of particular importance in these times of economic slowdown because revenues are distributed and help offset unfavorable regional developments. Strong finances at the government level are also a reassuring factor in combating the shake-up in the employment sector following the considerable automotive sector layoffs.

For further analysis of the Swedish local government sector, see article titled "Strong Fundamentals And Institutional Reforms Bolster Performance Of Swedish LRGs," published Feb. 8, 2008, on RatingsDirect.

Economy

A dynamic local economy, albeit concentrated in manufacturing and automotive

Västra Götaland comprises 49 municipalities, including Sweden's second-largest city, Göteborg (Gothenburg; AA+/Stable/A-1+). It is Sweden's second-most populous county after Stockholm County Council (AA+/Stable/A-1+) and has more than 1.5 million inhabitants, or about 17% of the national population.

The macroeconomic structure is somewhat tilted toward the manufacturing and automotive industries. Even though

the region's economic structure has become increasingly dynamic and well diversified in recent years, manufacturing still accounts for about 19% of the region's employment, which is higher than the national average of 17% for this sector.

The region is exposed to the automotive sector, through Ford Motor Co. (B-/Watch Neg/NR), owner of Volvo Cars, which employs about 2% of the regional workforce; General Motors Corp. (B-/Watch Neg/NR), owner of Saab Automobile, which employs about 1.0%; and heavy truck manufacturer Volvo, which employs less than 1.0%. Moreover, the automotive industry provides work for supporting industries, as well, and many small subcontractors are located in Västra Götaland.

The slight concentration in the automotive sector makes the region somewhat vulnerable to changes in the industry. This exposure was particularly acute in October this year, when Volvo announced layoffs of about 3,000 people in Västra Götaland. The region is in talks with the national government to prepare a support program, with the region contributing SEK100 million to research within the automotive sector. Even though the layoffs at Volvo will have consequences both for affected municipalities and the region's finances, the region should be able to cope with these difficulties due to its dynamic and well-diversified structure.

Unemployment in line with national average but could increase due to automotive layoffs

The region's unemployment rate is largely in line with national trends. At year-end 2007, it was 2.8%, which mirrored the national average. It is likely that the economic slowdown, exemplified by the automotive sector layoffs, will raise unemployment both in Västra Götaland and Sweden as a whole. Nevertheless, we expect no material effect on the region's finances, because national rescue packages and the equalization system will offset many of the negative financial implications. Moreover, Västra Götaland generates nearly 17% of Sweden's GDP. The region's per capita GDP was 99% of the national average in 2006, which corresponds to about 145% of the EU-27 average.

Västra Götaland has more than 1.5 million inhabitants. The region experienced solid population growth, with an increase of 0.6% in 2007, which was similar to Sweden's average national growth rate of 0.8%. We expect the population growth rate to decrease slightly in the coming years.

Management Capacity And Institutional Legitimacy

Health care is the main responsibility

Västra Götaland has the same legal status and obligations as a county. It was formed in January 1999 through the merger of the three counties of Bohuslän, Älvsborg, and Skaraborg, and the transfer of some functions previously managed by Gothenburg, such as hospitals and cultural activities.

A coalition of Social Democrats, Liberals, and the Center Party currently leads the region. Overall, there is healthy cooperation between politicians and Västra Götaland's management team.

The region's main responsibility is health care, which accounts for about 90% of expenditures. It is also responsible for the planning of regional development issues. In addition, it provides services related to public transport, real estate management, some cultural activities, tourism, and some upper secondary education. The region consolidates nine companies in its financial reporting. With the exception of the public transport company, the entities in the Västra Götaland group of companies are of minor financial significance.

Proposed structural reform under discussions

The conclusions from the parliamentary Committee on Public Sector Responsibilities ("Ansvarsutredningen"), initiated in 2003, are currently under discussion. A central aspect of the proposal is the merger of counties into larger administrative units. Nevertheless, as Västra Götaland was established only in 1999 and is of an adequate size (as stipulated in the committee's conclusions), there would be no major changes to its geographic borders even if Swedish LRGs are reorganized according to the committee's proposal. We will continue to closely monitor developments on possible changes to assess any potential effects on credit quality.

Financial Flexibility

Fairly good income flexibility in an international comparison

Swedish LRGs have complete autonomy in setting their local income taxes, which provides for revenue flexibility. Such taxes made up 70% of Västra Götaland's operating revenues in 2007. The remainder comprised state transfers (20%) and fees and charges (10%).

The region's revenue flexibility is still somewhat constrained, however, especially because, at SEK31.90, the total tax rate (the average municipal tax rate plus the county tax rate) is higher than the national average of SEK31.45. Nevertheless, the county tax rate of SEK10.45 is below the national average of SEK10.73. When compared internationally, however, Swedish LRGs have fairly good revenue flexibility, due to their autonomy in setting and levying income tax.

User fees and charges for most services are capped by national legislation or by other means that are difficult to adjust, and offer only marginal additional revenues.

Västra Götaland's financial performance is strongly influenced by its expenditure structure, with about 90% attributable to health care. Expenditure flexibility is constrained because a large proportion of the operating cost goes toward providing compulsory labor-intensive services. These expenses are difficult to rationalize without either affecting the quality and quantity of services or violating the central government's rules on how these mandatory services should be provided.

The region's infrastructure is satisfactory, with good health care facilities. The rate of investment is therefore low compared with international peers; in addition, some investments that have been forecast could be deferred, if needed.

Budgetary Performance

Continued sound budgetary performance, but expenditures are increasing quicker than revenues

Västra Götaland's finances have been sound and have continuously improved since the region was formed in 1999. Even so, this better financial picture is partly a result of tax increases of 8% in 2001 and 2% in 2005.

The region closed 2007 with a strong 5.0% operating surplus to operating revenues, slightly down from 7.0% one year earlier. As the region is well invested and capital spending is moderate, it posted a good 1.0% surplus after capital expenditures at year-end 2007. Estimates for 2008 indicate a sound operating balance at 4.0% of operating revenues. Furthermore, the forecast to 2011 indicates average annual surpluses of about 3.0% of operating revenues

with accounts after investments to average slight deficits at around negative 1.0%. Västra Götaland plans for investments to average a relatively high SEK2 billion. Nevertheless, some of these investments could be deferred should the financial situation of the region so require.

At the moment, expenditures are increasing more quickly than revenues, which will require savings measures and continued expenditure containment for finances to remain sound throughout the planning period. In 2008, the region has taken several measures to cut costs and increase efficiency to improve the financial situation at several regional hospitals. Uncertainty regarding developments in Sweden's bleak economic environment will also be a constraining factor in terms of declining tax revenues for the next few years. Nevertheless, Standard & Poor's expects the region to achieve its budgetary targets in the short term, with sound and stable financial results in 2008, but with challenges arising in 2009 and onward. Going forward, prudent expenditure containment with a focus on strict cost control should be the norm.

Liquidity And Debt Management

Strong liquidity and predictable cash flows

Västra Götaland's borrowing is centralized and is managed through the county treasury. Debt management is prudent. Moreover, the region has no foreign currency exposure. The use of derivative instruments is regulated by the county's prudent financial policy, and these are allowed for hedging purposes only.

Västra Götaland's cash flows are relatively predictable; there are regular dates for large ingoing and outgoing payments, which are evenly spread over the month and year. The region's liquidity is strong, with cash, short-term investments, and committed facilities equivalent to 19% of operating expenditures at year-end 2007.

Debt Burden

Net creditor position, although pension liabilities create net financial liability

At year-end 2007, the region had no direct debt. Moreover, the region does not expect to incur any debt accumulation in the planning period through 2011. Thus, according to the region's forecasts to 2011, investments will be largely financed by internal funding, and therefore direct debt is expected to remain close to 0%.

Standard & Poor's assesses unfunded pension obligations as debt like. As these obligations for the region corresponded to about 68% of total revenues at year-end 2007, its net financial liabilities (tax-supported debt plus unfunded pension liabilities minus free cash and equivalents) were 61% of total revenues at the same date. Much of the increase in unfunded pension liabilities is due to imminent changes in the calculation of the present value of these pension obligations, where the discount rate has been lowered one percentage point, together with an increase in the life expectancy factor. Moreover, due to changes in the price base amount used for calculating the pension liabilities, a further increase in pension liabilities will come into effect in 2009. Furthermore, in 2007, the region placed about SEK1 billion of its net liquidity into a separate pension fund. This fund will act as a reserve to mitigate future pension payments.

Contingent Liabilities

Västra Götaland has limited contingent liabilities. Excluding pension liabilities, Västra Götaland has contingent liabilities in the form of guarantees corresponding to less than 0.4% of operating revenues. We expect the amount of guarantees provided by the region to stay near this low level in the future.

Public transport company requires financial support, but carries limited risk

The largest entity among Västra Götaland's consolidated companies is the public transport company, Västtrafik. (Västra Götaland owns 50% of Västtrafik, with the remainder held by the region's 49 municipalities). Västtrafik is, however, a controlled entity within the Västra Götaland company group, because the region appoints most board members. The company requires the support of its owners in the form of a regular shareholder contribution, and Västra Götaland's contribution amounted to SEK897 million in 2007, which is equivalent to about 2% of the region's operating expenditures.

Table 2

Region of Vastra Gotaland Financial Statistics						
	--Year ended Dec. 31--					
(Mil. SEK)	2011f	2010f	2009f	2008e	2007	2006
Currency	SEK	SEK	SEK	SEK	SEK	SEK
Exchange Rate Date	31/12/2011	31/12/2010	31/12/2009	31/12/2008	31/12/2007	31/12/2006
Exchange Rate to USD	7.2	7.2	7.2	6.9	6.6	7.4
Operating revenues	47,323.3	45,552.5	43,826.3	42,254.0	38,564.0	36,073.0
Operating expenditures	45,757.9	44,160.5	42,466.5	40,466.0	36,581.0	33,602.0
Operating balance	1,565.4	1,392.0	1,359.8	1,788.0	1,983.0	2,471.0
Operating balance (% of operating revenues)	3.3	3.1	3.1	4.2	5.1	6.9
Capital revenues	N.A.	N.A.	N.A.	48.0	16.0	0.0
Capital expenditures (capex)	1,982.0	2,036.0	2,076.0	2,137.0	1,726.0	1,254.0
Balance after capex	(416.6)	(644.0)	(716.2)	(301.0)	273.0	1,217.0
Balance after capex (% of total revenues)	(0.9)	(1.4)	(1.6)	(0.7)	0.7	3.4
Modifiable revenues (% of operating revenues)	84.9	84.3	83.7	82.9	79.0	79.4
Capex (% of total expenditures)	4.2	4.4	4.7	5.0	4.5	3.6
Operating-revenue growth (%)	3.9	3.9	3.7	9.6	6.9	4.5
Operating-expenditure growth (%)	3.6	4.0	4.9	10.6	8.9	3.5
Debt and liquidity						
Direct debt (debt outstanding at year-end)	95.1	95.1	95.1	14.0	89.0	32.0
Direct debt (% of operating revenues)	0.2	0.2	0.2	0.0	0.2	0.1
Cash plus committed facilities (% of operating expenditures)	N.A.	N.A.	N.A.	18.3	19.0	24.0

Source: Data from issuer. f--Forecast. b--Budgeted. e--Estimated. p--Planned. SEK--Swedish krona. N.A.--Not available.

Table 3

Region of Vastra Gotaland Economic Statistics							
--Year ended Dec. 31--							
(SEK)	2010f	2009f	2008e	2007	2006	2005	2004
Exchange Rate Date	31/12/2010	31/12/2009	31/12/2008	31/12/2007	31/12/2006	31/12/2005	31/12/2004
Population (000's)	1,558.5	1,553.9	1,549.2	1,544.6	1,535.4	1,526.0	1,518.4
Population growth	0.3%	0.3%	0.3%	0.6%	0.6%	0.5%	0.4%
Unemployment rate	N.A	N.A	N.A	2.8	3.7	4.1	4.1
GDP (nominal)	582,672.2	558,872.1	538,868.3	514,089.6	485,850.3	454,222.0	436,288.5
GDP (nominal) per capita	372,229.7	358,745.6	347,570.5	333,205.9	316,438.1	297,665.8	287,334.6

Sources: Population and unemployment data: Standard & Poor's. GDP data: Experian. f--Forecast. e--Estimated. SEK--Swedish krona. N.A.--Not available.

Ratings Detail (As Of November 6, 2008)*

Vastra Gotaland (Region of)

Issuer Credit Rating	AA+/Stable/A-1+
<i>Nordic National Scale Rating</i>	--/--/K-1
Commercial Paper	
<i>Nordic National Scale Rating</i>	K-1

Issuer Credit Ratings History

07-Nov-2007	AA+/Stable/A-1+
21-Jun-2007	AA/Positive/A-1+
21-Aug-2001	AA/Stable/A-1+
06-Feb-2004	<i>Nordic National Scale Rating</i> --/--/K-1

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:

International Public Finance Ratings Europe; PublicFinanceEurope@standardandpoors.com

Additional Contact:

International Public Finance Ratings Europe; PublicFinanceEurope@standardandpoors.com

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