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Research Update:

Swiss Canton Of Basel-City 'AA+/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- We expect the Swiss Canton of Basel-City will continue to achieve strong budgetary performance in our forecast horizon to 2019, based on healthy tax revenues and expenditure control.
- The canton benefits from the extremely predictable and supportive institutional framework for Swiss cantons, its very strong economic profile, and an exceptional liquidity position.
- We are affirming our 'AA+/A-1+' ratings on Basel-City.
- The stable outlook reflects the canton's strong budgetary performance with almost-balanced results after capital accounts in 2016-2019. It also reflects our view that Basel-City's financial management will preserve sound planning practices and that its finances from 2020 could withstand the impact from the corporate tax reform III thanks in part to the canton's high level of preparedness.

Rating Action

On Nov. 25, 2016, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the Swiss Canton of Basel-City. The outlook is stable.

Rationale

The ratings on Basel-City benefit from the extremely predictable and supportive institutional framework for Swiss cantons. The ratings are further supported by Basel-City's very strong economy and its exceptional liquidity. In line with many Swiss cantons, Basel-City enjoys a strong degree of budgetary flexibility and the canton has a strong financial management. In addition, we also view the canton's budgetary performance as strong, given the track record of consistent outperformance of its financial plans. We assess the canton's debt level as moderate. The ratings also reflect the canton's moderate but potentially sizable contingent liabilities related to Basler Kantonalbank, its cantonal bank. Our current assessment of the canton's stand-alone credit profile is at 'aa+', equal to the long-term rating.

Compared with our last review, we note minor changes to the institutional framework under which Swiss cantons operate. For instance, the system provides for intercantonal equalization transfers, for which Basel-City is a major contributor due to its very favorable economic and financial profile. The canton will be required to make a net contribution of Swiss franc (CHF) 109 million (about €101 million) in 2017. These payments are primarily based on the canton's tax resource index, which has increased to 146.5 from 143.5 previously. In addition, we note that the corporate tax reform III could significantly affect the canton's finances. The canton is currently preparing to implement the reform, but effects on its revenues are expected only from 2020. In our view, the canton is adequately prepared to handle the reform's impact.

Under its political framework, Swiss cantons enjoy a great amount of budgetary flexibility, which we assess as strong for Basel-City. The canton reports a high share of modifiable operating revenues close to 80%, which also includes the modifiable municipal taxes. We estimate capital expenditures to amount to about 10%-12% of total expenditures in the upcoming years, reflecting the canton's currently underway ambitious investment plan.

In our view, Basel-City boasts a very strong economy. The city is home to some of the most important corporations in the pharmaceutical and chemical sector globally. Accordingly, the canton's GDP per capita, which we estimate at about CHF161,000, is exceptionally high in an international comparison. Despite being heavily export-dependent, the canton weathered the effects of the appreciation of the Swiss franc in 2015-2016. In addition, the canton's economic growth is projected to slightly exceed the Swiss national average over the next years. Although the pharmaceutical/chemical industry is of high importance for the local economy, this sector's significance does not translate into an elevated risk of highly volatile tax revenues in the coming years due to the sector's expected sound performance.

We continue to assess Basel-City's budgetary performance as strong, and we have observed an improving trend in the cantonal finances. Basel-City has consistently outperformed its financial plans, especially with regards to tax revenues. The canton's 2015 financial results were very strong, including an operating balance of 15.5% of operating revenues and a surplus after capital accounts of 6.0% to total revenues, according to our calculations. For our 2016 base-case scenario, we consider some tax-revenue growth as well as slightly lower capital expenditures. Additionally, we include a CHF414.5 million capital injection into the canton's pension fund as capital expenditures due to its one-time nature. We understand that the canton intends this amount to cushion the effects from the change to the pension plan (to defined contributions from defined benefits) on active members and protect their acquired rights. Considering the currently very high coverage ratio of the pension fund, alongside a change in the law governing the pensions fund that will allow for partial coverage, we do not anticipate another substantial one-time payment to the fund in the near future. This year's payment will result in a deficit after capital expenditures of 7% of total revenues for 2016. However, we project that rising tax revenues will enable the canton to post merely slightly negative results after capital accounts over 2017-2019, despite Basel-City's very ambitious investment plans for the upcoming years--with a peak of investments projected in 2017.

The recent financial results have also benefitted from the current administration's prudent cost-containment measures. We still consider the financial management of the canton as strong, but we have noticed several improvements with regard to long-term planning and visibility. In particular, we note the administration's proactive approach to preparing for the effects of the upcoming corporate tax reform, which will particularly affect Basel-City. In short, the reform provides for the discontinuation of certain tax privileges of foreign holding, domiciliary, and mixed companies in Swiss cantons from 2020. This will be accompanied by a higher cantonal share of direct federal taxes and more favorable taxation of revenues from patents and research and development activity in general ("license box" model).

Nevertheless, the reform is expected to result in a net negative effect for cantonal finances, notably for Basel-City, since the estimated share of tax revenues derived from these special status companies is the highest of all Swiss cantons. We expect that the canton's current financial management will effectively prepare for the impact of this tax reform ahead of its implementation.

With the recent increase in direct debt on the back of the capital injection into the cantonal pension fund, we project that Basel-City's stock of direct debt to reach 93% of operating revenues in 2018. We view this ratio as moderate in an international comparison, but it exceeds the debt ratio of many of Basel-City's domestic peers. The canton does not have any debt outstanding denominated in foreign currency. In the recent past, Basel-City frequently issued short-term debt to fully take advantage of the current low-interest environment. More recently, the canton has diversified the maturity profile of its debt stock with some issuances coming due in 20 years.

Basel-City's main contingent liability is Basler Kantonalbank, its cantonal bank, as the canton legally guarantees practically all of the bank's liabilities. In our opinion, Basel-City's creditworthiness could feel constrained if the bank called on the guarantee or had to rely on the canton for significant capital contributions. However, we currently view the likelihood of such a scenario as remote. The canton's other contingent liabilities, such as its guarantees, are minor relative to operating revenues. We therefore assess the canton's contingent liabilities as moderate overall.

Liquidity

Basel-City has exceptional liquidity, in our view. Cash, liquid assets, and committed facilities cover more than 120% of debt service over the next 12 months. Moreover, our assessment of the canton's liquidity takes into account the strong access of all Swiss cantons to liquidity in the domestic market.

In fact, the canton has reduced its own cash levels due the current low interest rate environment. Despite the reduction of liquid assets, however, we do not observe a deterioration of the canton's liquidity position. In the past year, Basel-City has signed a CHF900 million credit line (previously CHF500 million) with its cantonal bank. Furthermore, the canton has decreased its amount of short-term debt and has issued bonds with an extended maturity profile, up to 20 years, which reduces Basel-City's annual debt service in relation to operating revenues.

Based on the canton's liquidity planning and excluding debt service and gross borrowing, we estimate the canton's own average cash at above CHF80 million. Considering the CHF900 million committed credit line with Basler Kantonalbank, the canton reports a coverage ratio well exceeding our 120% threshold. Furthermore, Basel-City benefits from strong access to the deep, liquid Swiss capital market, as demonstrated by regular bond issues, even in times of heightened financial market volatility.

Outlook

The stable outlook on Basel-City reflects our opinion that the canton will maintain its strong budgetary performance, benefitting from sound tax-revenues, over 2016-2019. In our view, this should enable the canton to implement its investment plan while posting only slightly negative results after capital accounts on average. Furthermore, we expect that, over the coming two to three years, the canton's financial management will continue its prudent approach concerning cost-containment measures and liquidity policies.

We could raise our ratings on Basel-City if the canton sustains the improvements we have observed over the past years regarding long-term financial planning, coupled with balanced results after capital accounts going forward and a decreasing path of debt relative to operating revenues. In that vein, the effective implementation of the measures prepared by the canton in order to weather the significant challenges ahead pertaining to the third round of corporate tax reform, could lead us to raise our ratings--if it is coupled with maintaining the necessary room to maneuver in the budget to preserve sound fiscal results in light of the reform. This would support our view of the canton's political and managerial strength and its track-record of long-term planning.

We could lower the ratings if Basel-City significantly and structurally reduces its own liquid assets and committed facilities relative to debt service, including the rollover of short-term debt. This would also weigh on our financial management assessment. We could also lower the ratings if Basler Kantonalbank calls upon the canton for support. However, we currently view this scenario as unlikely.

Key Statistics

Table 1

Canton of Basel-City Financial Statistics

	--Fiscal year end Dec. 31--						
(Mil. CHF)	**2013**	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**	**2019bc**
Operating revenues	3,765	3,985	4,209	4,071	4,096	4,173	4,243
Operating expenditures	3,451	3,620	3,558	3,564	3,659	3,766	3,839
Operating balance	314	365	651	507	438	407	404
Operating balance (% of operating revenues)	8.3	9.2	15.5	12.4	10.7	9.8	9.5
Capital revenues	135	39	38	14	74	13	13
Capital expenditures	292	354	433	806	496	465	463
Balance after capital accounts	157	50	257	(285)	16	(45)	(46)
Balance after capital accounts (% of total revenues)	4.0	1.2	6.0	(7.0)	0.4	(1.1)	(1.1)
Debt repaid	730	1,001	1,408	668	301	800	400
Balance after debt repayment and onlending	(573)	(952)	(1151)	(953)	(285)	(845)	(446)
Balance after debt repayment and onlending (% of total revenues)	(14.7)	(23.7)	(27.1)	(23.3)	(6.8)	(20.2)	(10.5)
Gross borrowings	1,041	1,239	879	1,253	285	845	446
Balance after borrowings	468	288	(272)	300	0	0	0

Table 1

Canton of Basel-City Financial Statistics (cont.)

	--Fiscal year end Dec. 31--						
(Mil. CHF)	**2013**	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**	**2019bc**
Operating revenue growth (%)	N.M.	5.8	5.6	(3.3)	0.6	1.9	1.7
Operating expenditure growth (%)	N.M.	4.9	(1.7)	0.2	2.6	2.9	1.9
Modifiable revenues (% of operating revenues)	77.0	78.3	75.7	79.4	76.9	76.8	76.7
Capital expenditures (% of total expenditures)	7.8	8.9	10.8	18.4	11.9	11.0	10.8
Direct debt (outstanding at year-end)	3,559	3,797	3,268	3,853	3,837	3,882	3,928
Direct debt (% of operating revenues)	94.5	95.3	77.6	94.6	93.7	93.0	92.6
Tax-supported debt (% of consolidated operating revenues)	94.5	95.3	77.6	94.6	93.7	93.0	92.6
Interest (% of operating revenues)	1.6	1.3	0.9	0.9	0.9	0.9	1.1
Debt service (% of operating revenues)	21.0	26.4	34.4	17.4	8.2	20.1	10.5

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. N.M.--Not meaningful. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Table 2

Canton of Basel-City Economic Statistics

	--Fiscal year end Dec. 31--						
	2013	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**	**2019bc**
Population	189,335	190,580	191,757	193,223	194,537	195,875	197,267
Population growth (%)	N.M.	0.7	0.6	0.8	0.7	0.7	0.7
GDP per capita (CHF)	164,506	163,632	161,505	161,020	162,469	165,394	169,198
Unemployment rate (%)	3.7	3.6	3.8	N/A	N/A	N/A	N/A

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. Sources typically include national statistical offices, Eurostat, and Experian Limited. CHF--Swiss franc. N.M.--Not meaningful. N/A--Not applicable. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 3

Canton of Basel-City Ratings Score Snapshot

Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Strong
Budgetary performance	Strong
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	Moderate

*S&P Global Ratings' credit ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

- Swiss Confederation 'AAA/A-1+' Ratings Affirmed; Outlook Stable - November 18, 2016

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Public Finance System Overview: Swiss Cantons - November 03, 2016
- Sovereign Risk Indicators - October 13, 2016. An interactive version is available at www.spratings.com/sri.
- Banking Industry Country Risk Assessment: Switzerland - September 02, 2016
- Default, Transition, and Recovery: 2015 Annual International Public Finance Default Study And Rating Transitions - June 30, 2016

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

	Rating	
	To	From
Basel-City (Canton of)		
Issuer Credit Rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Stable/A-1+
Senior Unsecured		
Local Currency	AA+	AA+

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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site 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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