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## Research Update:

# Swiss Canton of Basel-City 'AA+/A-1+' Ratings Affirmed On Strong Budgetary Performance; Outlook Stable

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## Research Update:

# Swiss Canton of Basel-City 'AA+/A-1+' Ratings Affirmed On Strong Budgetary Performance; Outlook Stable

## Overview

- We expect the Swiss Canton of Basel-City will continue to post a strong budgetary performance in 2016-2018 on sound tax revenues and prudent operating expenditure control.
- Basel-City benefits from the extremely predictable and supportive institutional framework for Swiss cantons and a very strong local economy.
- We are affirming our 'AA+/A-1+' ratings on Basel-City.
- The stable outlook reflects our expectation that Basel-City's budgetary performance will remain strong amid increasing investment expenditures and the canton's strong financial management will preserve its strong liquidity.

## Rating Action

On Nov. 27, 2015, Standard & Poor's Ratings Services 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, as well as by the canton's strong financial management. Basel-City continues to post a strong budgetary performance and has strong budgetary flexibility. We assess the canton's debt as moderate. The ratings also reflect the canton's moderate but potentially sizable contingent liabilities related to Basler Kantonalbank, its cantonal bank. Our assessment of the canton's stand-alone credit profile is at 'aa+', equal to the long-term rating.

Swiss cantons operate under one of the most predictable and supportive institutional frameworks worldwide. Basel-City is one of the major donor cantons to the intercantonal equalization scheme, with a net contribution of Swiss franc (CHF) 93 million (about €86 million) in 2016. In the next implementation period in 2016-2019, the ongoing discussion to reform the equalization system will overlap with intense talks on Switzerland's corporate tax reform III, because the latter will also affect equalization payments. This tax reform will--after 2019--not only affect the intercantonal equalization system but also cantonal tax revenues. Depending on the final agreement, Basel-City's tax revenues could decline, but we expect the canton will have enough leeway to offset the limited shortfalls we currently expect. The canton would be affected because of its tax revenue structure and its related economic profile. With a projected GDP per capita of CHF170,000 and a tax resource

index of 143.5 in 2016, we view the canton's economy as very strong in an international perspective. We expect that Basel-City will be able to continue to grow slightly above the national average over the next two to three years, depending on the international economic environment and on how the world-leading chemical and pharmaceutical companies in the canton weather the impact of the strong Swiss franc on their exports. In our view, their significance for the local economy does not translate into an elevated risk of highly volatile tax revenues in the next few years, thanks to the canton's diversified economy.

The Swiss institutional setup gives Swiss cantons high revenue flexibility. Basel-City can set its tax rates and multipliers independently, leading to budgetary flexibility over almost 80% of operating revenues. Moreover, we do not expect that the potential requirement for approval of tax increases by referendum would constrain adequate tax adjustments, if needed.

We project that the canton will exhibit sound tax revenue growth in 2016-2018 and post an operating balance of 7.5% of operating revenues on average in 2016-2018. The strong operating performance is underlined by the savings measures implemented from 2015 by the canton's strong financial management, an approach which underpins our assessment of management's prudence and its commitment to sustainable finances. Tax revenue growth and operating expenditure control will enable the canton to contain deficits after capital accounts despite high projected investments, especially in educational facilities. Although we incorporate lower capital expenditures in our base case than the canton's financial planning envisages, deficits after capital accounts will amount to about 5% of total revenues on average in 2016-2018.

This includes the injection of CHF415 million into the canton's pension fund in 2016, which we include as capital expense to reflect its onetime nature in our 2016 base case for Basel-City. 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.

We expect Basel-City's tax-supported debt will stabilize at 98% of operating revenues by 2018, which we view as moderate in an international comparison. Basel-City is a regular issuer in the Swiss capital market, and the canton has increasingly taken on debt with relatively short maturities. Consequently, debt service is comparatively high. We view refinancing risk currently as mitigated by the canton's exceptional liquidity, however.

The cantonal pension fund had a high coverage ratio of 102% in 2014 and because the new law governing the pension fund includes, among other changes from 2016, a switch to partial capitalization, we anticipate that the need for large onetime cash injections into the fund by the canton should be significantly reduced. Under the revised framework, beyond the 2016 contribution, the canton has introduced further measures to strengthen the coverage ratio following a reduction of the technical interest rate.

Basel-City's main contingent liability is its cantonal bank. The canton legally guarantees practically all of Basler Kantonbank's liabilities. The ratings on Basel-City could come under pressure 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 low. The canton's other contingent liabilities, such as 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. In addition to that, our assessment of the canton's liquidity takes into account the strong access of all Swiss cantons to liquidity in the domestic markets.

In our view, Basel-City benefits from strong access to the deep, liquid Swiss capital market, as demonstrated by regular bond issues, even in distressed financial markets. Furthermore, the canton has a credit line of CHF500 million with Basler Kantonbank.

The canton had liquidity reserves of more than CHF900 million on average over the past 12 months. It has highly predictable cash inflows and outflows, on which it forms its liquidity planning. Given the canton's refinancing needs, debt service--including rollover of short-term debt--will stay at comparatively high levels of well above 20% of operating revenues over the next 12 months in our base-case scenario.

## **Outlook**

The stable outlook reflects our expectation that Basel-City will post a strong budgetary performance with sound operating surpluses, helped by sound tax revenue growth and recently introduced savings measures, over our 2016-2018 forecast horizon. We continue to assume that the canton will post a stronger budgetary performance than outlined in its current financial planning and the canton's management will maintain prudent financial policies.

We could consider a positive rating action if Basel-City's budgetary performance improved significantly, with balanced results after capital accounts on average over the forecast horizon. If this coincides with further strengthening in the visibility on long-term capital planning, we could revise up our financial management assessment.

We could lower the ratings if Basel-City structurally reduced the coverage of debt service, including the significant short-term portion of debt, by its liquid assets and committed facilities. This would also weigh on our financial management assessment. We could also lower the ratings if the canton were called upon to support Basler Kantonbank. However, we currently view this scenario as unlikely.

## **Key Statistics**

**Table 1**

**Canton of Basel-City Financial Statistics**

(Mil. CHF)	--Fiscal year ending Dec. 31--						
	2012	2013	2014	2015bc	2016bc	2017bc	2018bc
Operating revenues	3,771	3,765	3,985	3,984	3,871	3,950	3,998
Operating expenditures	3,401	3,451	3,620	3,614	3,564	3,652	3,715
Operating balance	370	314	365	370	306	298	283
Operating balance (% of operating revenues)	9.8	8.3	9.2	9.3	7.9	7.5	7.1
Capital revenues	48	135	39	27	14	40	40
Capital expenditures	257	292	354	378	799	428	396
Balance after capital accounts	161	157	50	19	(478)	(89)	(73)
Balance after capital accounts (% of total revenues)	4.2	4.0	1.2	0.5	(12.3)	(2.2)	(1.8)
Debt repaid	500	730	1,001	1,670	665	300	800
Net budget loans	0	0	0	0	0	0	0
Balance after debt repayment and onlending	(339)	(573)	(952)	(1,651)	(1,143)	(389)	(873)
Balance after debt repayment and onlending (% of total revenues)	(8.9)	(14.7)	(23.7)	(41.2)	(29.4)	(9.8)	(21.6)
Gross borrowings	535	1,041	1,239	1,500	865	350	850
Balance after borrowings	196	468	288	(151)	(278)	(39)	(23)
Operating revenue growth (%)	(18.3)	(0.2)	5.8	(0.0)	(2.8)	2.1	1.2
Operating expenditure growth (%)	(17.1)	1.5	4.9	(0.2)	(1.4)	2.5	1.7
Modifiable revenues (% of operating revenues)	79.8	77.0	78.3	77.5	78.3	77.4	77.4
Capital expenditures (% of total expenditures)	7.0	7.8	8.9	9.5	18.3	10.5	9.6
Direct debt (outstanding at year-end)	3,284	3,559	3,797	3,627	3,827	3,877	3,927
Direct debt (% of operating revenues)	87.1	94.5	95.3	91.0	98.9	98.1	98.2
Tax-supported debt (% of consolidated operating revenues)	87.1	94.5	95.3	91.0	98.9	98.1	98.2
Interest (% of operating revenues)	1.6	1.6	1.3	1.2	1.0	1.1	1.4
Debt service (% of operating revenues)	14.8	21.0	26.4	43.1	18.2	8.7	21.4

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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. Base case reflects Standard & Poor's expectations of the most likely scenario. CHF--Swiss franc.

**Table 2**

<b>Canton of Basel-City Economic Statistics</b>						
	<b>--Fiscal year ending Dec. 31--</b>					
	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015bc</b>	<b>2016bc</b>	<b>2017bc</b>
Population	187,425	189,335	190,580	191,130	192,390	193,640
Population growth (%)	0.6	1.0	0.7	0.3	0.7	0.7
GDP per capita (CHF)	166,520	165,605	168,712	168,120	170,310	174,765
Unemployment rate (%)	3.7	3.6	3.7	N/A	N/A	N/A

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices, Eurostat, and Experian Limited. bc--Base case reflects Standard & Poor's expectations of the most likely scenario. CHF--Swiss franc. N/A--Not applicable.

## Ratings Score Snapshot

**Table 3**

<b>Canton of Basel-City Ratings Score Snapshot</b>	
<b>Key rating factors</b>	
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

\*Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "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, Nov. 20, 2015

## 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

### Related Research

- Banking Industry Country Risk Assessment: Switzerland, Sept. 9, 2015
- Credit Trends: International Public Finance Downgrades Continued To Outpace Upgrades In First Quarter 2015, June 25, 2015
- Default, Transition, and Recovery: 2014 Annual International Public Finance Default Study And Rating Transitions, June 8, 2015
- Public Finance System Overview: Public Finance System Overview: Swiss Cantons, May 4, 2015

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+

Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at

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Outlook Stable*

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