

# RatingsDirect®

---

## Research Update:

# Swiss Canton of Basel-Country Affirmed At 'AA+/A-1+' Reflecting Healthy Economy And Liquidity; Outlook Stable

### Primary Credit Analyst:

Sabine Daehn, Frankfurt (49) 69-33-999-244; [sabine.daehn@standardandpoors.com](mailto:sabine.daehn@standardandpoors.com)

### Secondary Contact:

Ludwig Heinz, Frankfurt (49) 69-33-999-246; [ludwig.heinz@standardandpoors.com](mailto:ludwig.heinz@standardandpoors.com)

## Table Of Contents

---

Overview

Rating Action

Rationale

Outlook

Key Statistics

Ratings Score Snapshot

Key Sovereign Statistics

Related Criteria And Research

Ratings List

## Research Update:

# Swiss Canton of Basel-Country Affirmed At 'AA+/A-1+' Reflecting Healthy Economy And Liquidity; Outlook Stable

## Overview

- The Swiss Canton of Basel-Country has a very strong economy and exceptional liquidity due to an increase in available liquidity lines.
- Basel-Country faces a high debt burden as its planned recapitalization of its pension fund now also covers additional underfunded amounts owed by its municipalities.
- We are affirming our long-term and short-term ratings on Basel-Country at 'AA+/A-1+'.
- The stable outlook reflects our view that Basel-Country will continue to implement its savings measures over the next two years, stabilize its budgetary performance, and maintain its liquidity position.

## Rating Action

On July 18, 2014, Standard & Poor's Ratings Services affirmed its long-term issuer credit rating on the Canton of Basel-Country at 'AA+' and its short-term rating at 'A-1+'. The outlook is stable.

## Rationale

The ratings on Basel-Country benefit from the extremely predictable and supportive institutional framework for Swiss cantons and the canton's very strong economy. As the canton has contracted additional liquidity lines, its liquidity position has returned to exceptional, in our view. Our assessment of the canton's management as strong incorporates continued partial postponements of savings measures over the past years. That said, we view consolidation as achievable considering the canton's strong budgetary flexibility. Overall, we expect the canton's budgetary performance to remain weak over the coming two years, reflecting that the pension fund recapitalization is a one-time capital expenditure. In our opinion, this recapitalization will considerably increase Basel-Country's debt, moving it to our high category. Furthermore the canton has moderate contingent liabilities.

The ratings on Basel-Country reflect the canton's dynamic economy. GDP per capita, at about Swiss franc (CHF) 70,000 (\$77,000), is almost on par with the national average, making it one of the wealthiest regions in Western Europe. This also means that Basel-Country is a net payer in the Swiss fiscal equalization system, with a resource index of 101.6 in 2014 after 99.5 in 2013

(100 marks the national average for this index, which is an indicator of taxation resource potential among Swiss cantons). However, the budgetary impact for the canton is low, as the total volume of contributions is below 1% of operating expenditures. Overall, we view the institutional framework for Swiss cantons as mature, well-balanced, and extremely predictable.

Despite the robust economy and very low unemployment in Basel-Country, the canton still faces budgetary challenges due to both reduced tax revenue growth after the last tax reform became effective, and cost pressures, particularly for hospital financing and education spending. In our base-case assumption, we have included our belief that management will implement a majority of the savings measures proposed in its 2014-2017 financial plan. While delays are likely, we believe the canton will continue to apply prudent management policies and focus on structurally balancing its accounts over the medium term. Basel-Country is currently also reviewing its tasks and responsibilities to evaluate additional consolidation potential. This leads to our overall assessment of the canton's management as strong.

The canton has strong budgetary flexibility to achieve its consolidation plans, since about 80% of its revenues are modifiable. However, we believe political constraints mean the canton is currently unlikely to increase taxes but would instead adjust spending to counteract further structural deterioration in its financial position. The canton's current consolidation plan depicts this standpoint, comprising savings measures and expenditure cuts, such as a tightening grip on personnel costs.

We project in our base-case scenario that the canton's operating balance as a percentage of adjusted operating revenues will remain positive, at less than 2% on average over 2012-2016. While we see an improving trend despite reduced dividends from the Swiss National Bank in 2014 and 2015, we expect deficits after capital accounts because of the effects of several investment projects and the recapitalization of the pension fund.

A referendum in September 2013 approved the concept of recapitalizing the pension fund, and since then the plan has been updated to also include coverage by the canton for municipal-owed contributions for teachers' pensions. The full cash impact, in our view, will occur in 2015, when the debt is taken on, turning the implicit obligation into financial debt. We therefore expect Basel-Country's cash deficit after capital accounts to be greater than 15% of total adjusted revenues on average for 2012-2016, increasing the average deficit after capital accounts from about 7% in 2011-2013. However, including the recapitalization of the pension fund as a one-off cash expense in 2015 underestimates the medium-term budgetary performance. We believe Basel-Country's operating balance will remain below 5% of adjusted operating revenues until 2016. Combined with the annual investment program of about CHF300 million (approximately 12% of adjusted operating revenues), this signals an overall weak budgetary performance.

With the canton's increased capital injection into the pension fund, we now expect Basel-Country's debt to move beyond 120% of consolidated operating

revenues until 2016, a high level by international standards. Simultaneously, the canton's unfunded pension liabilities are set to fall to zero in 2015 and therefore will no longer weigh on our view of the debt burden. However, according to our expectations, debt is likely to increase steadily, beyond the pension fund contribution effect, due to ongoing deficits after capital accounts. Capital market developments during 2014 might change the final recapitalization amount to the pension fund, as the effective contribution will be determined according to year-end 2014 pension underfunding.

We also factor into our assessment the canton's moderate contingent liabilities, the largest of which is the ownership of 74% of Basellandschaftliche Kantonalbank. Basel-Country provides a statutory guarantee for its liabilities. Given the bank's stand-alone credit profile of 'aa-', we currently regard the likelihood of the guarantee being called as low. A pooling and guarantee mechanism securing the full recapitalization of the cantonal pension fund is also incorporated into our assessment of Basel-Country's contingent liabilities.

## **Liquidity**

We view Basel-Country's liquidity as exceptional, including access to external funding. The volume of its liquid assets reduced sharply in 2011 and 2012, but has remained fairly stable since 2013. As of December 2013, the volume of free cash stood at CHF184 million, and we incorporate the canton's increased contracted bank lines at CHF465 million into our assessment. The canton has on average free cash, liquid assets, and committed bank lines available to cover more than 120% of the next 12 months' debt service, including a CHF100 million bond maturing in the first half of 2015.

We regard the canton's access to external liquidity as strong and factor this into our assessment of its liquidity as exceptional. This is in line with our favorable view of Switzerland's banking sector (see "Banking Industry Country Risk Assessment: Switzerland," published Dec. 6, 2013, on RatingsDirect).

## **Outlook**

The stable outlook reflects our view that the canton will continue its consolidation efforts, stabilize its structural budgetary performance, and retain exceptional liquidity.

We might consider a positive rating action if the canton's management succeeded in reversing the trend of increasing debt, with a very solid positive operating performance partially compensating for investment expenditure increases, as well as lower costs relating to the pension fund recapitalization. This could also improve our view of the canton's managerial strength.

We might consider a negative rating action if the canton's consolidation efforts deteriorated, resulting in sustained very weak budgetary performance

that would increase debt significantly beyond our current expectations. A deterioration in our assessment of the canton's flexibility and willingness to adjust revenues or expenditures in light of further structural challenges could also put the canton's ratings under pressure, as would a change in our liquidity assessment.

We currently view both scenarios as unlikely.

Note: A supplementary analysis is available in German. Please send an e-mail to [PublicFinanceEurope@standardandpoors.com](mailto:PublicFinanceEurope@standardandpoors.com) to request a copy.

## Key Statistics

**Table 1**

Canton of Basel-Country Financial Statistics							
	--Year ending Dec. 31--						
(Mil. CHF)	2010	2011	2012	2013	2014bc	2015bc	2016bc
Operating revenues	2,654	2,726	2,335	2,328	2,387	2,447	2,508
Operating expenditures	2,604	2,666	2,295	2,318	2,380	2,436	2,433
Operating balance	50	60	40	9	7	11	75
Operating balance (% of operating revenues)	1.9	2.2	1.7	0.4	0.3	0.4	3.0
Capital revenues	81	72	75	83	43	50	64
Capital expenditures (capex)	198	420	186	298	233	1,900	333
Balance after capital accounts	(67)	(288)	(71)	(206)	(183)	(1,839)	(194)
Balance after capital accounts (% of total revenues)	(2.5)	(10.3)	(3.0)	(8.6)	(7.5)	(73.6)	(7.5)
Debt repaid	200	200	100	180	150	100	50
Balance after debt repayment and onlending	(267)	(488)	(171)	(386)	(333)	(1,939)	(244)
Balance after debt repayment and onlending (% of total revenues)	(9.8)	(17.4)	(7.1)	(16.0)	(13.7)	(77.7)	(9.5)
Gross borrowings	200	435	140	348	330	1,940	240
Balance after borrowings	(67)	(52)	(31)	(38)	(3)	1	(4)
Operating revenue growth (%)	3.6	2.7	(14.3)	(0.3)	2.6	2.5	2.5
Operating expenditure growth (%)	5.0	2.4	(13.9)	1.0	2.7	2.3	(0.1)
Modifiable revenues (% of operating revenues)	80.61	80.28	80.71	80.81	81.32	82.43	82.85
Capital expenditures (% of total expenditures)	7.1	13.6	7.5	11.4	8.9	43.8	12.0
Direct debt (outstanding at year-end)	857	1,092	1,166	1,334	1,482	3,322	3,512
Direct debt (% of operating revenues)	32.3	40.1	49.9	57.3	62.1	135.8	140.0
Tax-supported debt (% of consolidated operating revenues)	32.3	40.1	49.9	57.3	62.1	135.8	140.0
Interest (% of operating revenues)	1.8	1.4	1.4	1.3	1.4	1.4	1.4
Debt service (% of operating revenues)	9.3	8.8	5.7	9.1	7.6	5.5	3.4

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. bc--Base case, reflects Standard & Poor's expectations of the most likely scenario. CHF--Swiss francs.

**Table 2**

Canton of Basel-Country Economic Statistics						
	--Year ending Dec. 31--					
	2010	2011	2012	2013	2014bc	2015bc
Population	274,400	275,400	276,540	280,070	282,870	285,700
Population growth (%)	0.6	0.4	0.4	1.3	1.0	1.0
GDP per capita (CHF)	69,563	70,271	70,335	70,975	72,390	73,980
Unemployment rate (%)	3.3	2.7	2.7	2.7	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--Standard & Poor's base-case scenario. CHF--Swiss francs. N/A--Not applicable.

## Ratings Score Snapshot

**Table 3**

Canton of Basel-Country Ratings Score Snapshot	
Key rating factors*	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Strong
Budgetary performance	Weak
Liquidity	Exceptional
Debt burden	High
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" summarizes how the eight factors are combined to derive the government's foreign currency rating.

## Key Sovereign Statistics

Sovereign Risk Indicators, June 9, 2014. Interactive version available at <http://www.spratings.com/sri>

## Related Criteria And Research

### Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- 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, Oct. 15, 2009
- Methodology And Assumptions: Analyzing The Impact Of Unfunded Pension Liabilities On The Credit Quality Of International Local And Regional Governments, July 31, 2009

## **Related Research**

- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Banking Industry Country Risk Assessment: Switzerland, Dec. 6, 2013
- Public Finance System Overview: Swiss Cantons, July 30, 2009

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.

## **Ratings List**

Ratings Affirmed

Basel-Country (Canton of)

Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+

### **Additional Contact:**

International Public Finance Ratings Europe; [PublicFinanceEurope@standardandpoors.com](mailto:PublicFinanceEurope@standardandpoors.com)

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 [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.

Copyright © 2014 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. 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.

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 acknowledgement 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 acknowledgement 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 nonpublic 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](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription) and [www.spcapitaliq.com](http://www.spcapitaliq.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](http://www.standardandpoors.com/usratingsfees).