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Research Update:

Swiss Canton of Basel-Country 'AA+/A-1+' Ratings Affirmed; Outlook Remains Stable

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Overview

- We believe the Swiss Canton of Basel-Country has a very strong economy and benefits from exceptional liquidity due to ample available liquidity lines and a stable liquid assets position.
- Following the recapitalization of its pension fund in 2014 and 2015, Basel-Country's debt has significantly increased.
- We are affirming our 'AA+/A-1+' ratings on Basel-Country.
- The stable outlook reflects our expectation that Basel-Country will maintain exceptional liquidity and post improved budgetary performance thanks to its renewed commitment to implement consolidation measures over the coming years.

Rating Action

On May 27, 2016, S&P Global Ratings affirmed its 'AA+/A-1+' long-and short-term issuer credit ratings on the Swiss Canton of Basel-Country. The outlook remains stable.

Rationale

The affirmation reflects our view of the extremely predictable and supportive institutional framework for Swiss cantons, as well as Basel-Country's very strong economy in an international context. Also, the ratings are supported by the canton's exceptional liquidity position, owing to a good debt service coverage ratio and strong access to external funding. Moreover, we factor in the canton's strong financial management and strong budgetary flexibility.

Following the recapitalization of the public pension fund that led to cash injections from the canton in 2014 and 2015, which we treat as capital expenditures, we expect Basel-Country's budgetary performance to remain weak. As such, we also believe that Basel-Country will display high tax-supported debt. In addition, we take into account Basel-Country's moderate contingent liabilities. The long-term rating on Basel-Country is at the same level as the canton's stand-alone credit profile, which we assess at 'aa+'.

In our view, Basel-Country continues to benefit from a wealthy and dynamic economy, with real GDP per capita estimated at close to Swiss franc (CHF) 67,000 (more than $75,000) in 2015, which is very high in an international context. However, in 2015, Basel-Country's economy suffered from a significant slowdown, as was the case across Switzerland. Going forward, we expect Basel-Country's GDP to increase in line with Switzerland's until 2017. The impact on the canton's finances is significant as the bulk of its operating revenues comprises locally collected taxes (close to 80% as of 2015). Like all Swiss cantons, Basel-Country has extensive legal flexibility in setting personal income and corporate profit tax rates, which leads us to assess its budgetary flexibility as strong. However, we currently regard its revenue-raising flexibility as limited in practice, because political considerations mean the canton is unlikely to increase taxes.

We understand that the upcoming federal reform of the cantonal lump sum taxation system for holding and auxiliary companies would lead to a reduction in revenues that will be partly mitigated by compensation from the Swiss Confederation. At this stage, the latter is not fully settled. However, Basel-Country estimates the reform would have a manageable impact, because this could lead to a reduction in revenues that could reach CHF20 million per year (or less than 1% of its operating revenues, including compensation from the Swiss Confederation) for an implementation from 2019. Given our view of the extremely predictable and supportive institutional framework for Swiss cantons, we would assume that this reform will be implemented progressively and be negotiated with cantons, notably with regards to financial compensation from the Swiss Confederation for cantons' tax cuts.

To meet this challenge and face raising cost pressure, especially related to hospital and education spending, as well as slower tax revenue growth, the canton has started this year to implement consolidation measures outlined in its 2016-2019 savings plan. This highlights Basel-Country's commitment to improve budgetary performance, a strategy we view positively. Moreover, we believe Basel-Country has very strong debt and liquidity management and displays good management of its related entities. This leads to our overall assessment of the canton's management as strong.

In 2015, Basel-Country increased its operating balance to 3.7% of operating revenues, whereas it posted an operating deficit of 1.5% in 2014. This improvement is higher than our previous base-case projection of 0.4% and is mainly linked to stronger-than-expected tax revenues especially on personal income tax, exceptional operating revenues derived from the Swiss National Bank, and a tight grip over operating expenditures (+1.7% compared with 2014). As in 2014, however, the 2015 balance after capital accounts is heavily affected by the second cash injection of CHF683 million that was linked to the recapitalization of the public pension fund. This amount also incorporates an additional CHF44 million that the canton disbursed to maintain the pension's fund coverage ratio. Nevertheless, going forward, we expect an decreasing deficit after capital accounts.

Under our base-case scenario, we expect that Basel-Country's budgetary performance will remain weak in 2016-2018. We anticipate that the operating balance will slightly increase to 3% of operating revenues in 2018 (in line with our previous base case). We expect that less dynamic tax revenues (in the context of lower GDP growth prospects) and increasing education and health expenses will be partly mitigated by the continuing implementation of consolidation measures, including on personnel expenditures and transfers. As in our previous review, we anticipate capital expenditures to average CHF250 million over 2016-2018, up from CHF183 million in 2015 (excluding the one-off cash injection to the public pension fund). This, combined with a slightly increasing operating margin, would lead to deficits after capital accounts of approximately 6% of total revenues in 2016-2018.

With the canton's total cash injection of CHF1.5 billion into the public pension fund in 2014 and 2015, Basel-Country's tax-supported debt reached 126% of operating revenues at year-end 2015. Simultaneously, the canton's unfunded pension liabilities fell to zero in 2015 and therefore no longer weigh on our view of the canton's debt burden, as the implicit obligation to cover pensions has turned into direct financial debt. However, due to sizable deficits after capital accounts, we expect the debt burden to increase steadily, reaching 142% by 2018.

We also factor into our assessment the canton's moderate contingent liabilities, the largest of which is the 74% ownership of Basellandschaftliche Kantonalbank. Basel-Country provides a statutory guarantee for the bank's liabilities. Given our stand-alone credit profile of 'a+' for the bank, we currently regard the likelihood of the guarantee being called as low.

Liquidity

We view Basel-Country's liquidity as exceptional, including access to external funding. The volume of average free cash in 2015 stood at about CHF231 million, and we incorporate the canton's contracted bank lines of CHF865 million into our assessment. Therefore, the canton has on average free cash, liquid assets, and committed bank lines available to cover more than 120% of the next 12 months of debt service, including estimated average short-term debt maturing.

In our view, the canton continues to exhibit strong access to external funding via the financial markets, as reflected in frequent public bond issues over the recent years.

Outlook

The stable outlook reflects our expectation that Basel-Country will maintain exceptional liquidity and post improved budgetary performance, thanks to its renewed commitment to implement consolidation measures over the coming years.

We might consider a negative rating action over the coming 12 months if the canton's consolidation efforts deteriorated, leading it to post sustained negative operating margins and, in turn, very weak budgetary performance. 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 constrain our ratings on the canton.

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 expenditures. This could also improve our view of the canton's managerial strength.

However, we view both our upside and downside scenarios as unlikely at this stage.

Key Statistics

Table 1

Canton of Basel-Country Financial Statistics

	--Fiscal year ending Dec. 31--				
(Mil. CHF)	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**
Operating revenues	2,323	2,490	2,466	2,495	2,573
Operating expenditures	2,357	2,398	2,438	2,447	2,496
Operating balance	(34)	93	28	48	77
Operating balance (% of operating revenues)	(1.5)	3.7	1.1	1.9	3.0
Capital revenues	37	20	37	31	43
Capital expenditures	1,005	866	201	273	278
Balance after capital accounts	(1,003)	(753)	(136)	(194)	(158)
Balance after capital accounts (% of total revenues)	(42.5)	(30.0)	(5.4)	(7.7)	(6.1)
Debt repaid	150	100	50	25	0
Balance after debt repayment and onlending	(1,153)	(853)	(186)	(219)	(158)
Balance after debt repayment and onlending (% of total revenues)	(48.9)	(34.0)	(7.4)	(8.7)	(6.1)
Gross borrowings	1,200	950	200	250	150
Balance after borrowings	47	97	14	31	(8)
Operating revenue growth (%)	(0.2)	7.2	(1.0)	1.2	3.1
Operating expenditure growth (%)	1.7	1.7	1.7	0.4	2.0
Modifiable revenues (% of operating revenues)	80.5	81.0	79.6	79.0	79.6
Capital expenditures (% of total expenditures)	29.9	26.5	7.6	10.0	10.0
Direct debt (outstanding at year-end)	2,447	3,136	3,286	3,511	3,661
Direct debt (% of operating revenues)	105.4	125.9	133.3	140.7	142.3
Tax-supported debt (% of consolidated operating revenues)	105.4	125.9	133.3	140.7	142.3
Interest (% of operating revenues)	1.4	2.2	1.9	1.4	1.5
Debt service (% of operating revenues)	7.8	6.2	3.9	2.4	1.5

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. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. CHF--Swiss franc.

Table 2

Canton of Basel-Country Economic Statistics

	--Fiscal year ending Dec. 31--				
	2014	**2015**	**2016bc**	**2017bc**	**2018bc**
Population	281,301	283,157	285,422	287,706	290,007
Population growth (%)	0.9	0.7	0.8	0.8	0.8
GDP per capita (CHF)	67,666	66,854	66,452	67,250	68,729
Unemployment rate (%)	2.7	2.8	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, 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. bc--base case reflects S&P Global Ratings' expectation of the most likely scenario. CHF--Swiss franc. 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

*S&P Global Ratings' 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 - May 20, 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

- Sovereign Risk Indicators - May 3, 2016. An interactive version is available at http://www.spratings.com/sri.
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments - April 21, 2016
- Banking Industry Country Risk Assessment: Switzerland - September 09, 2015
- Default, Transition, And Recovery: 2014 Annual International Public Finance Default Study And Rating Transitions - June 08, 2015
- Public Finance System Overview: Public Finance System Overview: Swiss Cantons - May 04, 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-Country (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)

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