S&P Global Ratings

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Summary:

Basel-Country (Canton of)

Primary Credit Analyst:
Michael Stroschein, Frankfurt (49) 69-33-999-251; michael.stroschein@spglobal.com

Secondary Contact:
Alois Strasser, Frankfurt (49) 69-33-999-240; alois.strasser@spglobal.com

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Summary:

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

Key Rating Factors

Credit context and assumptions	Base-case expectations
A favorable economic, institutional, and political backdrop supports Basel-Country's continuing consolidation efforts. • The canton benefits from Switzerland's economic growth and the dynamics of the pharmaceuticals sector. • Fiscal revenue composition facilitates absorption of corporate tax reform (TRAF) costs. • Election results and recent referendums signal continuing electoral support for consolidation.	S&P Global Ratings anticipates nearly balanced accounts and gradual deleveraging. • Previous consolidation efforts and completion of pension fund recapitalization should allow nearly balanced accounts after capital expenditures. • With no significant debt maturities until 2022, the canton displays excellent liquidity and will not require long-term borrowing for almost three years. • We therefore expect the debt ratio to decline gradually.

Outlook

Our outlook is stable because we forecast that Basel-Country will display roughly balanced accounts after capital revenues and expenditures. We assume the recapitalization of the canton's pension fund has now been largely completed and that there will be no net new borrowing until at least 2022. Additionally, we expect the canton's administration to keep focusing on budgetary discipline, backed by electoral support, for example in fiscal-related referendums.

Downside scenario

We could lower our ratings if Basel-Country's operating margins reduced markedly, either as a result of weaker fiscal discipline or adverse changes in the economic environment that led to wider deficits after capital accounts and possibly rising debt. Additionally, large unforeseen expenditure (for instance related to the pension fund, shareholdings, or subsidiaries) could also put pressure on the ratings if they caused a significant rise in Basel-Country's debt ratio.

Upside scenario

We might consider a positive rating action if the canton consistently posted surpluses after capital accounts, leading to a faster reduction in the debt ratio than we currently envisage. We would expect such an improvement to also reflect stronger management practices. In addition, we would need to remain convinced that the canton had concluded the pension fund's recapitalization in a fiscally benign and sustainable way.

Rationale

Basel-Country's 2018 results and preliminary data on budget execution during the first months of 2019 support our base-case expectation of strong operating margins and nearly balanced accounts after capital expenditures for the next three years. Accordingly, we anticipate that the canton's ratio of debt to operating revenues will decline gradually over this timeframe.

We believe that political support for the admistration's consolidation path remains intact, as indicated by the results of the cantonal election in April. Additionally, we assume that the cost of implementing the upcoming corporate tax reform TRAF are limited and manageable for Basel-Country, and that the canton's two recent payments to its pension scheme have now largely concluded the fund's recapitalization.

Favorable economic, institutional, and political environment continues to support budgetary consolidation

Macroeconomic conditions remain favorable for Basel-Country, although a widely expected dip in Swiss real GDP growth to below 2% for 2019 and 2020 will undoubtedly also affect the canton's economy. However, our estimate of Basel-Country's 2019 GDP per capita of more than Swiss franc (CHF) 72,000 ($72,000) attests to the outstanding strength of its economy in an international comparison.

The pharma industry, and particularly related services such as logistics and wholesaling, continues to fuel economic growth in Basel-Country. Since these are very export-dependent business activities, an interruption of Switzerland's access to the EU's common market, for example due to disputes regarding the relevant framework and bilateral agreements, constitutes the biggest risk to Basel-Country's economy.

We believe that Basel-Country can easily absorb the cost of the pending corporate tax reform TRAF, arguably the most relevant change to the very supportive institutional framework for Swiss cantons in many years. In this respect, the canton benefits from its rather residential suburban structure, and the resulting high share of taxes paid by natural persons (>70% of overall tax revenues). The proposed general corporate tax rate reduction to a uniform 13.45% from a maximum rate of 20.7%, and various associated measures, will therefore only result in net losses for the canton's budget of about CHF30 million-CHF50 million per annum, equivalent to less than 2% of operating revenues. This estimate now also includes CHF19 million for social compensation measures, which the canton agreed to pay to ensure widespread political support for the reform. Following acceptance of the proposed reform plans in the national referendum on May 19, 2019, we assume endorsement also in Basel-Country's parliament, and potentially in a cantonal referendum on Nov. 24.

In our view, the canton's recent focus on budgetary consolidation will not weaken and continues to enjoy sufficient electoral support. For our assessment of the financial management's strength, we consider that the current administration implemented further cost containment measures, headcount reductions, structural reforms, and efficiency gains between 2016 and 2018, which resulted in savings totaling almost CHF120 million. Together with the rejection of a costly proposal to cap individuals' health care insurance premiums in a referendum on Nov. 25, 2018, we take the reelection of the incumbent head of the canton's finance department in March this year as a clear signal that the canton's electorate continues to support his fiscal consolidation policies.

Beyond the various reform measures affecting expenditure, we note the canton's continuing ability to meaningfully influence its revenue position by altering major tax rates and multipliers. With cantonal tax receipts representing more than 70% of operating revenues, we consider Basel-Country's budgetary flexibility to be comparatively strong.

Nearly balanced accounts will allow gradual debt reduction

Basel-Country surpassed its budget in 2018 and looks on track to do so again in 2019, based on preliminary budget execution data for the first four months of this year. For 2019-2022, we expect a slight moderation of the operating margin to 8%-9%. Basel-Country achieved an operating surplus of 10.2% in 2018, according to our cash-focused calculation approach. However, last year's result benefitted from tax revenues exceeding budget by CHF95 million, due to special effects and a larger-than-planned profit distribution from the Swiss National Bank of CHF44 million. We understand that, from 2020, the cost of implementing the corporate tax reform TRAF will start to weigh on the canton's operating performance.

We believe Basel-Country will continue to display balanced or nearly balanced results after capital accounts in 2019-2022. Last year, total capital expenditure was about CHF80 million lower than budgeted, but the canton made an on-account payment of CHF100 million toward the expected underfunding of the pension fund in 2019, resulting in a deficit of just 0.3% of total revenues. However, from this year, we anticipate higher utilization of Basel-Country's capital expenditure budget, which will limit the canton's results after capital accounts to practically breakeven.

For our base case, we assume the cantonal pension fund's recapitalization has been completed and will, in the near future, no longer require cash contributions from the budget. We understand that the canton cured the shortfall, partly resulting from the fund's poor 2018 performance, with the CHF100 million payment in 2018 and a second net contribution of CHF66 million early in 2019, of which a further CHF38 million will be reimbursed by Basel-Country's municipalities later this year. The scheme's coverage ratio is therefore now back at around 100%, and its actuarial parameters have been better aligned with the current low-interest-rate environment. However, even after this operation, the canton retains a legal obligation to cover any future funding gaps at the fund up to CHF 201 million, of which CHF46 million would be reimbursable by its municipalities. Excess losses would fall upon the canton's employees and pensioners.

We anticipate that Basel-Country's ratio of debt to operating revenues will decline gradually toward 105% by 2022, as revenue rises and the absolute amount of outstanding debt decreases marginally. Fairly balanced accounts will allow the canton to avoid any new borrowings until 2022, when CHF540 million in debt maturities will require capital-market refinancing. Until then, we understand that Basel-Country intends to repay all maturing debt from existing cash and near-cash reserves, although it may resort to short-term, intrayear borrowings to bridge the usual seasonal fluctuations in cash flows.

The canton's liquidity position remains excellent, in our view. With no financial debt maturing in the second half of 2019 or in 2020, the canton's liquidity on March 31, 2019, of CHF433 million (consisting of cash in bank accounts and a credit balance with the Swiss Confederation's treasury) covers annual interest payments of less than CHF35 million multiple times. In addition, the canton benefits from various counterparty credit lines and established access to Switzerland's deep bond market for cantonal borrowers.

Although profitable and well capitalized, Basellandschaftliche Kantonalbank (BLKB) remains the economically most relevant contingent liability, primarily due to its balance sheet size relative to the canton's operating revenues. Basel-Country owns 74% of BLKB, and provides a statutory guarantee for the bank's obligations.

We note profitability issues at exhibition organizer MCH Group, in which Basel-Country holds a 7.8% stake. Also, a plan to merge Basel-Country's public hospitals with those of neighboring Basel-City was rejected in a popular referendum in February. We believe the canton will have to review its strategy regarding these two companies, and will eventually need to restructure CHF153 million of loans provided to its hospital. Yet we don't currently foresee any near-term cash impact for the canton's budget as a result.

Key Statistics

Table 1

Basel-Country (Canton of) Selected Indicators

	--Fiscal year end Dec. 31--					
(Mil. €)	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	2,763	2,773	2,758	2,735	2,733	2,749
Operating expenditures	2,449	2,489	2,527	2,505	2,504	2,508
Operating balance	314	283	231	231	229	242
Operating balance (% of operating revenues)	11.4	10.2	8.4	8.4	8.4	8.8
Capital revenues	15	28	37	71	57	50
Capital expenditures	161	320	281	316	296	268
Balance after capital accounts	168.3	(8.8)	(12.8)	(14.5)	(9.6)	23.2
Balance after capital accounts (% of total revenues)	6.1	(0.3)	(0.5)	(0.5)	(0.3)	0.8
Debt repaid	181	267	150	0	85	540
Gross borrowings	75	294	0	0	0	500
Balance after borrowings	26	(9)	(171)	(6)	(87)	(9)
Modifiable revenues (% of operating revenues)	75.6	76.0	76.6	77.8	78.7	78.9
Capital expenditures (% of total expenditures)	6.2	11.4	10.0	11.2	10.6	9.7
Direct debt (outstanding at year-end)	3,108	3,125	2,975	2,975	2,890	2,850
Direct debt (% of operating revenues)	112.5	112.7	107.9	108.8	105.7	103.6
Tax-supported debt (outstanding at year-end)	3,149	3,165	3,023	3,031	2,954	2,914
Tax-supported debt (% of consolidated operating revenues)	112.9	113.2	108.6	109.8	107.1	105.0
Interest (% of operating revenues)	1.5	1.3	1.2	1.2	1.1	1.3
Local GDP per capita (€)	68,943	70,887	72,432	74,004	75,632	N/A
National GDP per capita (€)	78,803	80,831	82,078	83,921	85,796	87,957

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. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Basel-Country (Canton of) 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 bases its ratings on local and regional governments on the 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 foreign currency rating on the government.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Local Government Debt 2019: Slower Debt Reduction For German States And Little Change For Swiss And Austrian LRG Debt, March 1, 2019
- Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Feb. 22, 2019
- Full Analysis: Basellandschaftliche Kantonalbank, Dec. 5, 2018
- Banking Industry Country Risk Assessment: Switzerland, Nov. 30, 2018
- Public Finance System Overview: Swiss Cantons, Nov. 20, 2018
- Institutional Framework Assessments For International Local And Regional Governments, Nov. 6, 2018
- International Public Finance Rating Trends: German, Austrian, And Swiss Local And Regional Governments, Oct. 22, 2018
- Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others?, Aug. 29, 2018

- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 2018

Additional Contact:
EMEA Sovereign and IPF; SovereignIPF@spglobal.com