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Research Update:

Swiss Canton of Basel-Country 'AA+/A-1+' Ratings Affirmed On Robust Economy And Exceptional Liquidity; Outlook Stable

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Overview

- The Swiss Canton of Basel-Country has a very strong economy and exceptional liquidity due to ample available liquidity lines and a stable liquid assets position.
- Basel-Country faces a high tax-supported debt burden following the recapitalization of its pension fund in 2014 and 2015.
- We are affirming our ratings on Basel-Country at 'AA+/A-1+'.
- The stable outlook reflects our view that Basel-Country will continue to implement saving measures over the coming years, improve its budgetary performance, and maintain healthy liquidity.

Rating Action

On July 17, 2015, Standard & Poor's Ratings Services affirmed its long- and short-term issuer credit ratings on the Swiss Canton of Basel-Country at 'AA+/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. Given that the canton has various liquidity lines and faces stable average liquid asset levels, its liquidity position remains exceptional, in our view. We assess the canton's financial management as strong and believe budgetary consolidation is 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 affecting 2014 and 2015. In our opinion, this recapitalization will considerably increase Basel-Country's debt, moving it to our high category in 2015. Furthermore, the canton has moderate contingent liabilities. The long-term rating on Basel-Country is at the same level as our 'aa+' assessment of the canton's stand-alone credit profile.

The ratings on Basel-Country reflect the canton's dynamic economy. GDP per capita, at about Swiss franc (CHF) 70,000 ($75,000) in 2015, according to our expectations, is slightly below the national average, but still one of the highest in Western Europe. This also keeps Basel-Country among the net payers in the Swiss fiscal equalization system, with a resource index of 100.1 in 2015 after 101.6 in 2014 (100 marks the national average for this index, which is an indicator of taxation resource potential among Swiss cantons). We believe Basel-Country will remain on the borderline between receiving and paying into the national equalization system.

However, the budgetary impact for the canton is very low, as the total volume of contributions is below 1% of operating expenditures, and amounts received would be similarly small. Overall, we view the institutional framework for Swiss cantons as mature, well-balanced, extremely predictable, and supportive.

Despite the robust economy and very low unemployment in Basel-Country, the canton faces budgetary challenges. Cost pressures, particularly for hospital financing and education spending, as well as slower tax revenue growth than anticipated, have contributed to weak budgetary results. In our base-case scenario, we have included our assumption that management will achieve saving measures as noted in its 2015-2018 financial plan. While delays cannot be ruled out, we believe the canton will continue to apply prudent management policies and focus on structurally balancing its accounts over the medium term. In addition, Basel-Country is currently reviewing its tasks and responsibilities to evaluate additional consolidation potential for its budgetary planning process for 2016-2019. This leads to our overall assessment of the canton's financial management as strong.

The canton has strong budgetary flexibility to achieve its consolidation plans, since about 80% of its revenues are modifiable. However, at this stage, we think political considerations mean the canton is 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 saving measures and expenditure cuts, such as a tightening grip on personnel costs with only limited revenue adjustments likely.

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 1% on average over 2013-2017. The 2014 budgetary result showed an operating deficit, but we forecast a slowly improving trend for the coming three years. The canton's 2014 and 2015 balance after capital accounts are heavily affected in cash terms due to the payments into the cantonal pension fund of a total of CHF1.44 billion. However, we also expect deficits after capital accounts going forward because of the effects of several investment projects.

A referendum in September 2013 approved the recapitalization of the cantonal pension fund. We thus expect Basel-Country's cash deficit after capital accounts to be materially greater than 15% of total adjusted revenues both in 2014 and 2015. We also continue to estimate the average deficit after capital accounts over our five-year forecast horizon for 2013-2017 to be greater than 15%. However, including the recapitalization of the pension fund as a one-off cash expense significantly underestimates the medium-term budgetary performance, which we currently expect to average a capital expenditure deficit between 5% and 10% of total adjusted revenues. We believe Basel-Country's average operating balance will remain below 5% of adjusted operating revenues until 2017. Combined with the annual net-investment program of about CHF200 million (approximately 8%-10% of adjusted operating revenues), this signals an overall weak budgetary performance.

With the canton's CHF1.44 billion capital injection into the pension fund, funded via bond issuances in 2014 and 2015, Basel-Country's debt moves beyond 120% of consolidated operating revenues in 2015, a high level by international standards from its low level in 2013. Simultaneously, the canton's unfunded pension liabilities are set to fall to zero in 2015 and therefore won't weigh on our view of the canton's debt burden, as the implicit obligation to cover pensions has turned into direct financial debt. According to our expectations, debt is likely to increase steadily, beyond the pension fund contribution effect, due to ongoing deficits after capital accounts.

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 'a+', 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 with respect to other related employers is also incorporated into our assessment of Basel-Country's contingent liabilities. However, the respective amount is low, at about CHF100 million at year-end 2014.

Liquidity

We view Basel-Country's liquidity as exceptional, including access to external funding. After a sharp reduction of its liquid assets in the past, the volume has remained fairly stable on average since 2013. The volume of average free cash in 2014 stood at about CHF200 million, and we incorporate the canton's contracted bank lines of CHF680 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' debt service, including a CHF50 million bond maturing in the first half of 2016 and estimated average short-term debt maturing.

We regard the canton's access to external liquidity as strong and factor this into our assessment of its liquidity. This is in line with strong domestic demand for cantonal capital market issuance as well as our favorable view of Switzerland's banking sector, given our banking industry country risk assessment of '2' for Switzerland (see " Banking Industry Country Risk Assessment: Switzerland," published Jan. 7, 2015).

Outlook

The stable outlook reflects our view that the canton will continue its consolidation efforts, stabilize its structural budgetary performance, and retain exceptional liquidity, as well as contain debt increases at currently projected levels.

We might consider a negative rating action over the coming 12 months if the canton's consolidation efforts deteriorated, resulting in sustained 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 constrain the 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.

We currently view both scenarios as unlikely.

Key Statistics

Table 1

Canton of Basel-Country Financial Statistics

	--Fiscal year-end Dec. 31--					
(Mil. CHF)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	2,335	2,328	2,323	2,474	2,494	2,556
Operating expenditures	2,295	2,318	2,357	2,464	2,486	2,498
Operating balance	40	9	(34)	9	8	58
Operating balance (% of operating revenues)	1.7	0.4	(1.5)	0.4	0.3	2.3
Capital revenues	75	83	37	41	34	30
Capital expenditures	186	298	1,005	1,028	253	272
Balance after capital accounts	(71)	(206)	(1,003)	(978)	(211)	(184)
Balance after capital accounts (% of total revenues)	(3.0)	(8.6)	(42.5)	(38.9)	(8.3)	(7.1)
Debt repaid	100	180	150	100	50	25
Balance after debt repayment and onlending	(171)	(386)	(1,153)	(1,078)	(261)	(209)
Balance after debt repayment and onlending (% of total revenues)	(7.1)	(16.0)	(48.9)	(42.9)	(10.3)	(8.1)
Gross borrowings	140	348	1,200	950	260	200
Balance after borrowings	(31)	(38)	47	(128)	(1)	(9)
Operating revenue growth (%)	(14.3)	(0.3)	(0.2)	6.5	0.8	2.5
Operating expenditure growth (%)	(13.9)	1.0	1.7	4.5	0.9	0.5
Modifiable revenues (% of operating revenues)	80.7	80.8	80.5	78.6	79.1	79.6
Capital expenditures (% of total expenditures)	7.5	11.4	29.9	29.4	9.2	9.8
Direct debt (outstanding at year-end)	1,166	1,334	2,447	3,297	3,507	3,682
Direct debt (% of operating revenues)	49.9	57.3	105.4	133.3	140.6	144.1
Tax-supported debt (% of consolidated operating revenues)	49.9	57.3	105.4	133.3	140.6	144.1
Interest (% of operating revenues)	1.4	1.3	1.4	2.3	1.8	1.8
Debt service (% of operating revenues)	5.7	9.1	7.8	6.4	3.8	2.8

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 franc.

Table 2

Canton of Basel-Country Economic Statistics

	--Fiscal year-end Dec. 31--					
	2012	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Population	276,537	278,656	281,266	284,000	286,750	289,450
Population growth (%)	0.4	0.8	0.9	1.0	1.0	0.9
GDP per capita (CHF)	68,205	69,363	70,715	70,360	71,720	73,700
Unemployment rate (%)	2.7	2.7	2.7	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

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 "https://www.globalcreditportal.com/ratingsdirectshowArticlePage.do?object_id=8636295&rev_id=2htmlArticlext_artcl-mark-hyperlnk 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

Sovereign Risk Indicators, June 30, 2015. An interactive version is available at

http://www.spratings.com/sri.

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

- 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 08, 2015
- Public Finance System Overview: Public Finance System Overview: Swiss Cantons - May 04, 2015
- Banking Industry Country Risk Assessment: Switzerland - January 07, 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

	Ratings	
	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+

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 Standard & Poor's public Web site at 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.

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