FitchRatings

Fitch Affirms Swiss Canton of Zurich at 'AAA'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 19 July 2019:

Fitch Ratings has affirmed the Swiss Canton of Zurich's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'AAA' with Stable Outlooks.

Fitch assesses the canton's Standalone Credit Profile (SCP) at 'aaa', reflecting the combination of a 'Stronger' risk profile, and debt sustainability assessed in the 'aaa' category under Fitch's rating case scenario. The SCP also factors in peer comparison. The IDRs are not affected by any asymmetric risk or extraordinary support from the central government.

The canton of Zurich is the largest canton in Switzerland in terms of population and GDP, contributing 18% of the national population and about 22% of national GDP. Its population of over 1.5 million inhabitants is still growing due to net migration. Its wealth can be assumed well above the national average, which is in turn two times higher than the EU-28 average. Zurich has a broad service sector focused on financial institutions, insurance and real estate services as well as public services.

Key Rating Drivers

Revenue Robustness Assessed as Stronger

Zurich's revenue robustness is assessed as Stronger in view of the canton's stable revenue sources with revenue growth prospects in line with national GDP growth. Tax revenue accounts for about 44% of Zurich's operating revenue (in 2018), based on moderately cyclical economic activities, with personal income tax (PIT) accounting for about 70% of the canton's tax revenues.

The other two main sources of the canton's operating revenues are transfers (31% of operating revenue) and charges and fees (25%).

We assume all of the canton's operating revenues are of moderate cyclical nature, as proceeds from PIT are not necessarily changing in line with the economic cycle and transfers and fees have not shown large volatility in the past.

Revenue Adjustability Assessed as Stronger

Zurich's ability to generate additional revenue in response to possible economic downturn is Stronger, supported by the proven track record of revenue growth, even in times of lower GDP growth.

Cantons in Switzerland have a high degree of autonomy and are independent from the central government. This is expressed by a high degree of fiscal autonomy and Zurich has leeway in adjusting PIT rates. Zurich could adjust these tax rates but we assume the canton would be reluctant to do so, as this could lead to severe political and public discussions as well as a competitive disadvantage, as firms as well as people may decide to move to other cantons that apply lower tax rates. However, Zurich currently applies below average tax rates in the cantonal context.

The Stronger assessment of the Revenue Adjustability factor is further supported by revenue equalisation in place with Zurich being a net payer to the system.

Expenditure Sustainability assessed as Stronger

Zurich has a track record and good prospects of tight control of total expenditure growth. Spending growth is generally below revenue growth. The canton's main responsibilities are non-cyclical, including education, healthcare, social welfare and public safety as well as public transport.

Zurich has a good track record of control of operating expenditure growth. Opex has generally grown in line with operating revenue growth, which has largely resulted in an operating surplus. Zurich has effective budget rules in place and committed itself to a medium-term balanced budget. This needs to show an overall surplus in an eight years tenor (considering the last three actual years, the current budgetary year and the four-year forecast). This is subject to review and if the medium-term surplus is not met, all departments are required to apply cost consolidation.

Expenditure Adjustability Assessed as Stronger

The canton's ability to reduce spending in response to shrinking revenue is Stronger. This is due to the effective budget balance rules in place. According to the canton, all necessary adjustments required to achieve a balanced budget, or to cope with a slowdown of revenues, will be adjusted towards spending rather than adjusting tax rates. The budget had some leeway for smaller adjustments to cope with cyclical swings of revenue and the canton has underperformed its investment budget. According to the canton's financial data for 2008-2018, capex realised has always been below the budget, which Fitch assumes as additional fiscal flexibility.

Liabilities & Liquidity Robustness assessed as Stronger

The liability and liquidity robustness of the canton is Stronger. Zurich has prudent debt management in place and well established access to the capital market. The debt is dominantly funded by bonds that have a bullet repayment, but there is no concentration risk in its maturity profile. According to the canton's medium-term financial plan, debt serving requirements (including maturing debt and interest expenses) will not exceed 20% of its debt outstanding at end-2018 over the next five years. Further, the canton is not exposed to floating rates and has no foreign currency debt pending. Zurich has a strong track record of liquidity and its liquidity ratio covered debt servicing at least by 1x in 2008 to 2018. Following the lower interest rate environment and as the canton partly was required to pay for its cash in accounts, liquidity was reduced and the canton aims to finance part of its maturing debt with more short-term options.

The canton's direct debt level and corresponding debt servicing is moderate. Its outstanding direct debt was CHF5,182 million at end-2018, corresponding to 34% of its operating revenue. Its payback (direct debt to operating balance) was five years in 2018, direct debt servicing accounted for a low 1.8% of its operating revenue and its operating balance covered interest paid by over 7x in 2018. According to our 2019-2023rating case, debt may increase to CHF6.3 billion by 2023, a level still in line with the rating.

The canton is exposed to contingent liabilities, which Fitch views of moderate risk. The largest single contingent liability stems from its guarantee provided to its 100% owned cantonal bank, Zuercher Kantonalbank (ZKB; AAA/Stable). This incorporates liabilities of the bank of CHF21.3 billion at end-2018, but we assume the canton would rather support the bank in terms of capital measures to prevent any event of default. Furthermore, the bank is supervised by the canton and its business profile is of limited risk. In addition to ZKB, the canton had CHF1.9 billion of contingent liabilities at end-2018, with the bulk of it commitments to its employees. The canton further has a 100% share in two entities, for which we view the canton finally liable for. Their debt accounted for a moderate CHF293 million at end-2018, which are of low risk.

Liabilities & Liquidity Flexibility assessed as Stronger

The canton's liabilities and liquidity flexibility is Stronger. This is based on its well established access to funding in the capital markets as a frequent bond issuer in the domestic market. Zurich is not largely focused on international placements, as its demand is fully satisfied in the domestic market and most recent funding was even placed at negative rates. Zurich has further sufficient liquidity in place covering usually its annual debt repayment needs and has a committed credit line with ZKB. We assume additional access to emergency liquidity available in the short term, reflected in its good track record in the capital market and its long history of being rated 'AAA' as well as the availability of the Swiss National Bank, which may also provide liquidity in case of need.

Debt Sustainability Assessment: 'aaa'

Fitch's rating case scenario forecasts the economic liability burden (net adjusted debt (+ pro rata share of central government debt / cantonal GDP) - the primary metric of debt sustainability assessment - will sustainable stay below 20% in 2019-2023, well below the threshold of above 40%, which would correspond to a 'aa' category.

The secondary metrics, the fiscal debt ratio (net adjusted debt to operating revenue) and the actual debt service coverage ratio (operating balance to debt service, including short-term debt maturities) will remain in its current 'aaa' assessment for the fiscal debt burden until 2023, while Fitch's rating case assumes a relatively weak debt service coverage ratio of below 1x. This is mitigated by the canton's cash in place as well as its short-term availability of liquidity ensuring debt service is covered at any time and the canton's debt sustainability is driven by its economic liability burden.

Derivation Summary

Based on the risk profile assessment and debt sustainability metrics, Fitch assesses the canton's SCP at 'aaa' SCP. The canton's IDRs are not capped by the sovereign rating (AAA/Stable/F1+) and there is no other factor affecting the rating. As a result, the canton's IDRs are equalised with its SCP.

The 'F1+'short-term rating reflect our Stronger assessment of the canton's debt structure's robustness and flexibility and a liquidity coverage ratio expected above 1.4x in our rating case in 2019.

Key Assumptions

Fitch's key assumptions within our base case for the issuer include:

- Growth tax revenue and transfers received in line with the issuer assumptions

- Growth of charges and fees in line with expected real GDP growth

- Growth of operating expenditure in line with the issuer's assumptions

- Capex in 2019 30% above that of 2018 and 2020-2023 growth in line with inflation based on 2019 capex

- Growth of interest payments in line with the issuer assumptions

- Funding gaps to be funded by cash available or additional debt

Fitch's rating case 2019-2023 envisages the following stress compared with the base case:

- Stress of tax revenue by -1pp annually

- Stress of operating expenditure by additional +1pp annually

- Starting 2020, adjustments in capex as the canton has shown a track record of underspending in case of need in the past

- Growth of interest payments in line with the projected debt growth

RATING SENSITIVITIES

Given the canton's tax dynamics and tax-raising potential, a downgrade is unlikely. However, an economic liability burden consistently above 40% according to Fitch's rating case coupled with a materialisation of its contingent liabilities, or its government-related entities requiring ongoing capital injections, would lead us to review Zurich's ratings.

Significant changes in the canton's financial leeway or additional financial obligations, in either the intra- or inter-cantonal context, could also be rating-negative. Negative rating action on Switzerland would also trigger rating action on Zurich.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Zurich, Canton of	LT IDR AAA Affirmed	AAA
	ST IDR F1+ Affirmed	F1+
	LC LT IDR AAA Affirmed	AAA
senior unsecured	LT AAA Affirmed	AAA

Additional information is available on www.fitchratings.com

FITCH RATINGS ANALYSTS

Primary Rating Analyst
Guido Bach
Senior Director
+49 69 768076 111
Fitch Deutschland GmbH
Neue Mainzer Strasse 46 - 50
Frankfurt am Main D-60311

Secondary Rating Analyst
Nilay Akyildiz
Director
+49 69 768076 134

Committee Chairperson
Raffaele Carnevale
Senior Director
+39 02 879087 203

MEDIA CONTACTS

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Applicable Criteria

Rating Criteria for International Local and Regional Governments (pub. 09 Apr 2019)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

DISCLAIMER

COPYRIGHT

verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

UNSOLICITED ISSUERS

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Zurich, Canton of	-	Long Term Issuer Default Rating	Unsolicited
Zurich, Canton of	-	Short Term Issuer Default Rating	Unsolicited
Zurich, Canton of	-	Local Currency Long Term Issuer Default Rating	Unsolicited
Zurich, Canton of	-	Stand-Alone Credit Profile	Unsolicited
Zurich, Canton of CHF 400 mln 3.15% bond/note 21-Jan-2020	CH0015426478	Long Term Rating	Unsolicited
Zurich, Canton of CHF 450 mln 0.5% bond/note 03-Dec-2020	CH0199543528	Long Term Rating	Unsolicited
Zurich, Canton of CHF 175 mln 0.375% bond/note 06-Oct-2021	CH0254212225	Long Term Rating	Unsolicited
Zurich, Canton of CHF 300 mln 1.25% bond/note 29-Jul-2022	CH0217850673	Long Term Rating	Unsolicited
Zurich, Canton of CHF 190 mln 1.375% bond/note 06-Dec-2023	CH0224761533	Long Term Rating	Unsolicited
Zurich, Canton of CHF 210 mln 1.25% bond/note 07-Mar-2024	CH0236669591	Long Term Rating	Unsolicited
Zurich, Canton of CHF 240 mln bond/note 27-Jun-2025	CH0373476933	Long Term Rating	Unsolicited
Zurich, Canton of CHF 175 mln 1% bond/note 03-Dec-2025	CH0199543544	Long Term Rating	Unsolicited
Zurich, Canton of CHF 125 mln 1.625% bond/note 29-Jul-2026	CH0217850681	Long Term Rating	Unsolicited
Zurich, Canton of CHF 275 mln 0.01% bond/note 07-Sep-2026	CH0353945378	Long Term Rating	Unsolicited
Zurich, Canton of CHF 200 mln 1% bond/note 06-Oct-2027	CH0254212233	Long Term Rating	Unsolicited
Zurich, Canton of CHF 375 mln 1.25% bond/note 03-Dec-2032	CH0199543569	Long Term Rating	Unsolicited
Zurich, Canton of CHF 360 mln 2% bond/note 29-Jul-2038	CH0217850699	Long Term Rating	Unsolicited
SHOW MORE			

Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Fitch Updates Terms of Use & Privacy Policy

We have updated our Terms of Use and Privacy Policies which cover all of Fitch Group's websites. Learn more.