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Research Update:

Swiss Canton of Geneva Outlook Revised To Stable; 'AA-' Rating Affirmed

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Overview

- We believe Geneva continues to benefit from Swiss cantons' very favorable institutional framework, and from a very strong and expanding local economy that fuels its tax revenues, especially this year.
- In our view, these strengths will in the next two years offset Geneva's management's recent decisions, which we believe will widen deficits from 2020 following corporate tax cuts.
- We now expect that, in the longer term, possible future budgetary pressures from the upcoming corporate tax reform and recapitalization of Geneva's largest public pension fund in 2020 will not weaken the canton's credit profile substantially.
- We are therefore revising our rating outlook on Geneva to stable from negative and affirming our 'AA-' rating.

Rating Action

On Dec. 21, 2018, S&P Global Ratings revised its outlook on the Swiss Republic and Canton of Geneva to stable from negative, and affirmed its 'AA-' long-term issuer credit rating on the canton.

Outlook

The stable outlook reflects our expectation that Geneva will continue to benefit from its expanding economy and limit budgetary pressures from tax cuts under its corporate tax reform, while weathering the impact of recapitalizing its largest public pension fund, CPEG (Caisse de prévoyance de l'Etat de Genève) in 2020.

Downside scenario

We might consider a negative rating action if, in a less favorable economic environment, management's decisions continue to trigger large funding needs that would restrict the canton's budgetary flexibility, or if the canton failed to offset potential adverse effects of the public pension fund reform and the corporate tax reform's implementation.

Upside scenario

We could consider a positive rating action if the reform of CPEG resulted in a material decrease of unfunded pension liabilities and the canton mitigated the financial effects of the corporate tax reform implementation.

However, we consider both scenarios to be unlikely at present.

Rationale

The outlook revision stems from our assessment that Geneva's key structural strengths--Swiss cantons' very supportive institutional framework and Geneva's very strong and expanding local economy--will, over the next two years, counterbalance some recent management decisions that we foresee will widen deficits from 2020 following the planned corporate tax cuts. Under our base case, the canton will avoid further budgetary pressures from the upcoming corporate tax reform and recapitalizing CPEG.

Geneva can handle budgetary deterioration and avoid further large debt accumulation, thanks to its expanding economy, and despite looser management.

Thanks to our anticipation of very high tax revenues in 2018--supported by the dynamic local economy--Geneva will likely maintain a solid budgetary performance over our rating horizon through 2020. In 2018, we expect Geneva to post an operating balance exceeding 10% of operating revenues (versus 4.1% in our January 2018 base case) and a surplus after capital accounts of close to 4% of total revenues, versus a deficit of 4.2% in our January 2018 base case. However, we continue to expect in our base-case scenario a deterioration of budgetary performance from 2020 once the corporate tax reform is implemented. After some one-off tax revenues anticipated in 2018, Geneva's operating balance would decrease to about 7% of operating revenues in 2019 (from 10%), before dropping to about 2% in 2020, after the corporate tax reform takes effect. At the same time, we expect that increasing social aid and health expenses will weigh further on Geneva's operating balance.

We anticipate that the canton's capital expenditure (capex) will average Swiss franc (CHF) 645 million over 2018-2020, due to the ramping-up of projects, compared with about CHF550 million in 2016 and CHF630 million in 2017; however, these capex figures are lower than our previous base-case projection of CHF720 million. Coupled with lower operating margins, this will likely lead to deficits after capital accounts of 2% of total revenues in 2019 compared with a surplus anticipated at 4% in 2018 under our base-case scenario. We expect the deficit will widen to about 6% in 2020, at the time of the corporate tax reform's implementation.

Following cantonal elections in April/May this year, a new financial roadmap was presented, including the cantonal executive's commitment to mitigate the deterioration in budgetary performance through cost-cutting measures over the coming years, and implement the corporate tax reform and structural solutions for its ailing, and largest, public pension fund, CPEG. However, the canton's executive faces persistent difficulties in implementing structural solutions and meeting its budgetary and strategical targets, with looser revenue and expenditure management weighing on our overall assessment of its management. In our view, the canton displays prudent debt and liquidity management, and maintains sound control over its government-related entities.

In the context of increasing international pressure to reduce tax advantages granted to certain categories of companies in Switzerland, the Swiss Confederation drafted a project (Corporate Tax Reform III or CTR III) to reform the Swiss corporate tax system and abolish cantonal lump-sum taxation, aiming at more OECD-compliant corporate taxation. After this project was rejected in 2017 by a national referendum, the confederation and cantons started a new project (Tax proposal and AHV financing or TRAF), which they aim to enact from 2020 after a potential new referendum to be held in May 2019.

The corporate tax reform would lead to a large reduction in tax revenues under a corporate tax cut, likely resulting in the general corporate tax rate dropping to 13.99% from 24.2%. Geneva would benefit from compensation from the central government to cantons, which would offset some of the lost tax revenue. However, we understand that the canton will also implement new spending measures, including potentially inflationary expenses. In our base-case scenario, the overall impact of the reform would average 5% of Geneva's operating revenues from 2020, leading to a drop in the operating balance to about 2% of operating revenues in 2020 from 7% in 2019. In our view, the related impact of the reform will be structural dynamic pressure on the canton's budgetary performance from 2020, although still manageable for the canton under our base-case scenario.

The canton's public pension fund, CPEG, still faces significant unfunded pension liabilities, which were equivalent to about 100% of the canton's operating revenues in 2017. We note that two competing political projects have recently been adopted by the cantonal parliament, targeting minimum coverage ratios of 75% largely via recapitalizing in 2020 through a large debt-funded injection (more than CHF4 billion) from the canton. However, it remains unclear whether a structural solution will be implemented, since the competing projects disagree on a potential shift from the current defined-benefit scheme to a defined-contributions scheme. We will closely monitor further developments on the structural reform of the CPEG.

Given our expectation of widening deficits and a large recapitalization of CPEG in 2020, we anticipate that the canton's tax-supported debt will increase to about 167% of consolidated operating revenues by year-end 2020 from our estimate of 124% in 2018. We include in our calculation Geneva's direct debt and the debt of non-self-supporting government-related entities (transportation company TPG and public hospital HUG). Meanwhile, interest charges should remain limited at 2.5% of operating revenues on average through 2020. Despite the CPEG's recapitalization, Geneva may continue to record large unfunded pension liabilities, representing over 50% of its operating revenues at year-end 2020, although down from 100% at year-end 2017. These liabilities may remain sizable in the coming years and continue to constrain our assessment of the canton's debt burden.

A very strong and expanding local economy and favorable framework remain Geneva's key strengths.

We view Swiss cantons' institutional framework as extremely predictable and supportive, notably because major reforms are planned well in advance and widely discussed (including the current corporate tax reform), and transparency and accountability standards are very high. Swiss cantons display comparatively strong adequacy of revenues and expenditures, supported by equalization mechanisms. Compensating transfers from the Swiss Confederation under the corporate tax reform will partly mitigate Geneva's tax revenue losses, underlining our view of the favorable institutional framework for Swiss cantons.

In addition, Geneva continues to benefit from its wealthy and diversified economy, with real GDP per capita exceeding CHF97,000 (over $99,000) in 2017, which is very high in an international context. The impact of local GDP growth on the canton's finances is significant--as demonstrated by very high tax revenues in 2018; the bulk of Geneva's operating revenues consists of locally collected taxes (about 80% of operating revenues as of 2017).

Like all Swiss cantons, Geneva has extensive legal flexibility in setting personal income and corporate profit tax rates. However, we regard its revenue-raising flexibility as low in practice because tax hikes are subject to popular referenda and, given the nature of the corporations it hosts, Geneva is sensitive to tax competition. Combined with the largely rigid nature of operating expenditures (mostly consisting of personnel, social aid, and allowances and transfers for health care and public transport) and limited capex in an international comparison (7.5% of total expenditures on average over 2018-2020 in our base case; restated from CPEG's recapitalization) while high in national comparison, this supports our view of the canton's average budgetary flexibility.

In our view, the canton has moderate risks associated with its contingent liabilities, mainly through the cantonal bank Banque Cantonale de Geneve, of which it remains the largest shareholder; and public insurance institution Rentes Genevoises, which benefits from a cantonal guarantee for its liabilities.

We continue to assess Geneva's liquidity as adequate. We consider that Geneva has a weak debt-coverage ratio but strong access to external liquidity. We expect that the canton's average available amounts on its committed bank lines of CHF1.3 billion will cover more than 40% of its debt service over the next 12 months. In our view, the canton continues to benefit from strong access to external liquidity, as reflected by large short-term facilities, comprising CHF1.3 billion of contracted bank lines, as well as CHF4.6 billion of direct and indirect liquidity lines that are not formally contracted but generally available and regularly used, with various public-sector entities and Swiss and international banks. The canton has also been a frequent issuer of public bonds in recent years, and issued the first green bonds among Swiss local governments in 2017.

Key Statistics

Table 1

Geneva (Republic and Canton of) Selected Indicators

	--Fiscal year end Dec. 31--				
(Mil. CHF)	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	8,160	8,351	9,019	9,018	9,025
Operating expenditures	7,680	7,864	8,112	8,403	8,874
Operating balance	480	487	907	615	152
Operating balance (% of operating revenues)	5.9	5.8	10.1	6.8	1.7
Capital revenues	40	29	21	24	26
Capital expenditures	551	630	586	790	4,680
Balance after capital accounts*	(31)	(114)	342	(151)	(502)
Balance after capital accounts (% of total revenues)*	(0.4)	(1.4)	3.8	(1.7)	(5.6)
Debt repaid	1,123	1,163	750	825	862
Gross borrowings	915	1,073	250	826	5,264
Balance after borrowings	(239)	(204)	(158)	(150)	(100)
Modifiable revenues (% of operating revenues)	77.7	76.7	78.0	77.4	75.8
Capital expenditures (% of total expenditures)	6.7	7.4	6.7	8.6	34.5
Direct debt (outstanding at year-end)	12,466	12,375	11,875	11,876	16,278
Direct debt (% of operating revenues)	152.8	148.2	131.7	131.7	180.4
Tax-supported debt (outstanding at year-end)	13,237	13,180	12,734	12,761	17,190
Tax-supported debt (% of consolidated operating revenues)	141.7	138.0	124.4	124.3	167.0
Interest (% of operating revenues)	2.4	2.2	2.0	1.9	2.9
Local GDP per capita (nominal, CHF)	97,104	97,534	99,624	101,687	103,781
National GDP per capita (nominal, CHF)	78,436	78,803	81,033	82,812	84,619

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. *Restated from the public pension fund (CPEG)'s recapitalization. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. CHF--Swiss franc.

Ratings Score Snapshot

Table 2

Geneva (Republic and Canton of) Ratings Score Snapshot

Key rating factors	
Institutional framework	Extremely predictable and supportive

Table 2

Geneva (Republic and Canton of) Ratings Score Snapshot (cont.)

Key rating factors	
Economy	Very strong
Financial management	Satisfactory
Budgetary flexibility	Average
Budgetary performance	Average
Liquidity	Adequate
Debt burden	Very high
Contingent liabilities	Moderate

*S&P Global Ratings' credit 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" summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

- Sovereign Risk Indicators, Dec. 13, 2018. An interactive version is available at www.spratings.com/sri

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, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Public Finance System Overview: Swiss Cantons, Nov. 20, 2018
- Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Nov. 16, 2018
- Institutional Framework Assessments For International Local And Regional Governments, Nov. 6, 2018
- Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others?, Aug. 29, 2018
- Swiss Cantonal Bank BCGE Rating Not Immediately Affected By Recent Initiative To Demand Repayment Of State Aid, Feb. 20, 2018

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 Affirmed; Outlook Action

	To	From
Geneva (Republic and Canton of)		
Issuer Credit Rating	AA-/Stable/--	AA-/Negative/--
Senior Unsecured	AA-	AA-

Additional Contact:
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