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Research Update:

Swiss Republic and Canton of Geneva Rating Affirmed At 'AA-'; Outlook Still Negative

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Overview

- The Swiss Canton of Geneva continues to benefit from a very strong economy, favorable institutional framework, and strong financial management.
- Meanwhile, we still expect that implementing the federal corporate tax reform will reduce corporate tax proceeds from 2020, structurally weakening the canton's budgetary performance.
- We are affirming our 'AA-' long-term rating on the canton.
- The outlook remains negative, reflecting a potential debt-funded recapitalization of the canton's largest public pension fund, which could substantially increase the canton's debt burden while not fully solving the unfunded pension liabilities.

Rating Action

On Jan. 26, 2018, S&P Global Ratings affirmed its 'AA-' long-term issuer credit rating on the Swiss Republic and Canton of Geneva. The outlook remains negative.

Outlook

The negative outlook continues to reflect our view that a potential large, debt-funded recapitalization of its largest public pension fund, CPEG (Caisse de prévoyance de l'Etat de Genève) may structurally lift the canton's debt burden, in a context of projected decreased revenues as a result of the corporate profit tax reform. We could lower the rating if, after recapitalization, the canton's tax-supported debt significantly exceeded 180% of consolidated operating revenues, while, despite a substantial increase in debt, the unfunded pension liabilities would remain sizable.

Upside Scenario

Conversely, we could revise the outlook on the canton to stable if we consider our downside-case scenario as less likely--reflecting a more limited impact of the potential recapitalization of CPEG on the canton's debt burden and a stronger decrease in the unfunded pension liabilities--and other factors continued to perform in line with our base-case scenario.

Rationale

The rating reflects our view that the Canton of Geneva continues to benefit from an extremely predictable and supportive institutional framework, strong management, and a very strong economy. At the same time, the planned corporate tax reform will likely lead from 2020 to a reduction of the canton's revenues, widening of its deficit, and ultimately a higher debt burden.

The canton's relatively low debt service coverage ratio is somewhat mitigated by its good access to a diversified pool of Swiss financial institutions.

Very strong economy, favorable framework, and strong financial management remain strengths for the canton

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 a comparatively strong adequacy of revenues and expenditures, supported by equalization mechanisms. The supportiveness of the canton's institutional framework is also reflected by the likely transfers from Switzerland under the corporate tax reform, which should partially mitigate the Canton of Geneva's tax revenues losses.

In addition, the Canton of Geneva continues to benefit from a wealthy and diversified economy, with real GDP per capita exceeding Swiss franc (CHF) 97,000 (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, since the bulk of its operating revenues consists of locally collected taxes (about 80% as of 2017).

We continue to view Geneva's financial management as strong, since we still view as positive the cantonal executive's commitment to mitigate the deterioration in budgetary performance through cost-cutting measures over recent years, and to seek a structural solution for its public pension by recently addressing a draft bill aimed at recapitalization of its largest public pension fund, CPEG. Moreover, in our view, the canton continues to display good long-term financial planning, prudent debt and liquidity management, and maintain sound controls over its government-related entities.

Like all Swiss cantons, Geneva has extensive legal flexibility in setting personal income and corporate profit tax rates, but 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 capital expenditures (capex) in an international comparison (8.1% of total expenditures on average over 2018-2020 under our base-case scenario), this supports our view of the canton's average budgetary flexibility.

Large, unfunded pension liabilities will continue to constrain the canton's debt burden

We expect Geneva will record weak budgetary performance over our rating horizon through 2020, reflecting structural reduction in its budgetary performance and our expectation that the canton will implement the corporate tax reform from 2020. Under our base case, the operating balance will slightly increase to 4.1% of operating revenues in 2018, due to more dynamic tax revenues, reflecting higher local GDP growth prospects, and cost-control and -cutting measures. However, these rising operating revenues will be mitigated by pressures on the expenditure side owing to a strong increase in Geneva's contribution to the Swiss cantonal equalization system from 2018 and increasing social aid and health expenses.

In the context of increasing international pressure to reduce tax advantages granted to companies in Switzerland, the central government had drafted a project ("Réforme de l'imposition des entreprises III" or RIE III) to reform the Swiss corporate taxation system, and abolish cantonal lump-sum taxation. While this project was rejected by national popular referendum in February 2017, Switzerland and the cantons are working on a new project ("Project fiscal 17" or PF17), aiming to enact it from 2020. These active negotiations are being led with an eye to financial compensation from the central government for cantons' reduced corporate tax revenues, and we understand at this stage that PF17's effects for Geneva could be very close to those we projected for the previous RIE III. The canton would face a reduction in tax revenues under a corporate tax cut (Geneva had previously stated its willingness to cut its general corporate tax to 13.49% from 24.2%) but also benefit from partial compensation from the central government to cantons, leading to a negative operating balance in 2020 (-0.1%). In our view, the related tax revenue losses will be a structural pressure element on the canton's budgetary performance from 2020.

We anticipate that the canton's capex will average CHF720 million over 2018-2020 due to ramping-up projects, up from CHF550 million in 2016 and CHF630 million in 2017. This will likely lead to slightly increasing deficits after capital accounts averaging 4.4% of total revenues in 2018-2019 (compared with 3.9% in 2017), before rising to 8.3% in 2020, due to the corporate tax reform's implementation.

Given our expectation of increasing deficits after capital accounts, we anticipate that the canton's tax-supported debt will slightly increase to 152% of consolidated operating revenues at year-end 2020 from 142% in 2017. However, this is excluding a recapitalization of the public pension fund, which could lead to a consequent increase of the tax-supported debt. We include in our calculation of tax-supported debt Geneva's direct debt and the debt for 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 in 2020. Despite capital injection in 2012-2013, Geneva continues to record large unfunded pension liabilities, notably through CPEG, representing 108% of the canton's operating revenues at year-end 2016, up from 93% at year-end 2015, due to the lowering of the technical rate to 2.5% at end-2016. We expect these liabilities will remain sizable in the coming years, which negatively affects our assessment of the canton's debt burden.

In September 2017, the cantonal executive adopted measures aimed at implementing a structural solution for CPEG, which faces significant unfunded pension liabilities. The cantonal executive's project targets reaching a coverage ratio of 80% by recapitalizing CPEG with CHF4.7 billion, of which CHF4.5 billion would be taken over by the canton. The measures would also plan to shift the pension scheme for future pensioners from a defined benefit to a defined contributions scheme. However, such a reform would still require parliamentary approval and most likely be subject to a popular referendum. Regarding the context of upcoming cantonal elections in April-

May 2018, we do not factor the implementation of the public pension fund's recapitalization in our base-case scenario.

In our view, the canton has moderate risks associated with its contingent liabilities, mainly through the cantonal bank Banque Cantonale de Geneve (A+/Negative/A-1), of which it remains the largest shareholder, and public insurance institution Rentes Genevoises (not rated), which benefits from cantonal guarantee over 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 CHF3.5 billion of 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 bond in recent years, most recently through a green bond at end-2017.

Key Statistics

Table 1

Republic and Canton of Geneva Key Statistics

	--Fiscal year ending Dec. 31--				
(Mil. CHF)	**2016**	**2017e**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	8,158	8,143	8,388	8,507	8,361
Operating expenditures	7,681	7,864	8,043	8,195	8,372
Operating balance	477	279	345	312	(12)
Operating balance (% of operating revenues)	5.9	3.4	4.1	3.7	(0.1)
Capital revenues	40	30	24	24	24
Capital expenditures	550	630	725	725	710
Balance after capital accounts	(33)	(321)	(356)	(389)	(698)
Balance after capital accounts (% of total revenues)	(0.4)	(3.9)	(4.2)	(4.6)	(8.3)
Debt repaid	1,123	925	620	825	775
Gross borrowings	915	854	876	1,214	1,473
Balance after borrowings	(241)	(392)	(100)	0	0
Modifiable revenues (% of operating revenues)	77.7	77.2	77.2	77.5	75.0
Capital expenditures (% of total expenditures)	6.7	7.4	8.3	8.1	7.8
Direct debt (outstanding at year-end)	12,466	12,395	12,651	13,041	13,738
Direct debt (% of operating revenues)	152.8	152.2	150.8	153.3	164.3
Tax-supported debt (outstanding at year-end)	13,237	13,189	13,469	13,883	14,605
Tax-supported debt (% of consolidated operating revenues)	141.7	141.6	140.6	142.9	152.2

Table 1

Republic and Canton of Geneva Key Statistics (cont.)

	--Fiscal year ending Dec. 31--				
(Mil. CHF)	**2016**	**2017e**	**2018bc**	**2019bc**	**2020bc**
Interest (% of operating revenues)	2.4	2.4	2.4	2.4	2.5
Local GDP per capita (nominal, CHF)	97,528	97,245	98,872	100,630	102,622
National GDP per capita (nominal, CHF)	78,268	78,386	79,793	81,310	83,021

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.

Ratings Score Snapshot

Table 2

Republic and Canton of Geneva Ratings Score Snapshot

Key rating factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Average
Budgetary performance	Weak
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 – December 14, 2017. An interactive version is also 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
- General Criteria: Use Of CreditWatch And Outlooks - September 14,2009

Related Research

- Global Sovereign Rating Trends - January 10, 2018
- Sovereign Ratings History – January 05, 2018
- Sovereign Ratings List - January 05, 2018
- Sovereign Risk Indicators – December 14, 2017. An interactive version is also available at http://www.spratings.com/sri
- Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable - November 18, 2017
- Banking Industry Country Risk Assessment: Switzerland - November 06, 2017
- Credit Trends: 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions – April 18, 2017
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions – April 03, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion – Feb. 23, 2017

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 agreed that the key rating factors were unchanged.

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
Geneva (Republic and Canton of)		
Issuer Credit Rating		
Foreign and Local Currency	AA-/Negative/--	AA-/Negative/--

Ratings List Continued...

Senior Unsecured		
Local Currency	AA-	AA-
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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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) 783-4009.

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