S&P Global
Ratings

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Research Update:

Zurich, Switzerland's Largest City, Rated 'AA+'; Outlook Stable

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Overview

- The City of Zurich benefits from a very strong local economy and an extremely predictable institutional framework for municipalities in the Canton of Zurich.
- The city's management follows clear internal guidelines, managing its budget with balance between needs and financial capacity.
- We are assigning our 'AA+' long-term issuer credit rating to the city.
- The outlook is stable.

Rating Action

On Oct. 28, 2019, S&P Global Ratings assigned its 'AA+' long-term issuer credit rating to the City of Zurich (Zurich-City). The outlook is stable.

Outlook

The stable outlook reflects our expectation that, after years of budget surpluses, Zurich-City will resort to an only marginal deficit despite projected losses from corporate tax reform and a planned increase in capital spending. We also assume that the city will maintain a cushion of cash and contain any debt increase, with a largely stable and moderate debt burden of just above 60% of operating revenue.

Downside scenario

We could lower the ratings if the city substantially deviated from its financial policy, with deficits after capital accounts heading toward 10% of total revenues. In this scenario, the city would also resume its debt accumulation.

Upside scenario

We could raise the ratings if Zurich-City further reduced its debt burden, and further improved its cash cushion through improved budgetary performance, which could also reflect lower capital expenditure (capex) than we expect in our base-case scenario.

Rationale

The ratings reflect Zurich-City's very strong individual credit profile, ranging from very strong economy and financial management to strong budgetary performance, and very strong access to external liquidity. The ratings further reflect an extremely predictable and supportive institutional framework for municipalities in the Canton of Zurich (AAA/Stable/--). A relatively low cash reserve and moderate debt burden constrain the rating.

Zurich-City has a very strong economy, which provides a wealthy basis for local taxation. However, the constraints of a diverse socioeconomic urban population affect financial performance. The city is entering a cycle of new capex programs, among others, in its integrated utility sector, and will partially finance these investments through debt and liquidity. Nevertheless, debt remains moderate.

We expect that Zurich-City's very strong management team will manages its budget, including its capex program, in a manner compliant with its financial goal of balancing accrual operating accounts in the medium term and containing debt increases due to deficits after capital accounts beyond its own budget and financial plans. Zurich-City benefits from an extremely predictable institutional framework, which burdens its accounts by equalization payments, but also compensates for specific expenses of an urban center.

Very strong economy, with extremely predictable institutional framework for municipalities in the canton and management's adherence to strict financial policies

Zurich-City is the most important economic center for Switzerland, reflecting a highly diverse and dynamic economic structure, primarily in the services sector. We view Swiss GDP per capita as very high, at about $83,100 (2019), while the city's GDP per capita is twice as high. Zurich-City's economy is largely driven by the financial industry (28% of value-added for the local economy), which consists of different sectors such as commercial and investment banking, asset and wealth management, as well as insurance and reinsurance. Other important sectors include education, health, and culture. ETH Zürich ranks among the most prestigious universities in Europe, and the University of Zurich is also well known. The cantonal university clinic and city clinics, as well as elderly care facilities, are renowned institutions. Despite the financial industry's dominance, we do not see a concentration risk because of the sector's fragmentation and diversification, but understand structural changes in the industry will affect the city's economy. However, we believe it will need to rely on its adaptability to market and technological challenges.

We assess the institutional framework for municipalities in the Canton of Zurich as extremely predictable and supportive. This relies on the consensus-based approach of the canton and municipalities for structural and legal changes, avoiding unbalanced burdens for either. However, legally, municipalities cannot oppose changes provided that no referendum on these changes happens. A final backstop to unwanted changes for municipalities would always be a referendum, where municipal politicians could influence voters. Due to the strong municipal autonomy, extraordinary support for municipalities might be contained and the canton would likely need to pass specific legislation to support Zurich-City in an extraordinary case, a situation we view as only theoretical.

We assess the city management as very strong, because it adapted and strengthened some cantonal regulations of the fiscal framework for municipalities and clarified measurements, timeframes, and related issues (such as for the medium-term balanced budget). Furthermore, additional internal guidelines strengthen the predictability of the city's financial policy with clear targets, but also leave room for unforeseen challenges. These guidelines include a set of optional measures on budgetary flexibility ranging from adjusting the tax multiplier to cutting expenses, lowering the capex program, and setting guidelines for liquidity and debt management. We expect the city management will adapt to the challenges of the national corporate tax reform and increased capital program by applying the defined tools and implement required measures to maintain financial stability.

Strong budgetary performance is weakening, leading to a cash drain and increasing debt

We expect budgetary performance to moderately weaken in the medium term, due to the impacts of national corporate tax reform, the effects of accounting adjustments linked to the switch to the new harmonized accounting model, and an increased multi-year investment program. However, we expect the city's management will contain deficits after capital accounts. In 2016-2018, Zurich-City's budgetary performance was very robust with surpluses after capital accounts of 2.1% of total revenue on average. Beyond the increased capex program, budgets and financial plans reflect lower operating margins, remaining committed to the balanced budget requirement (in accrual terms). While tax revenues are forecast to increase in 2019-2020, 2021 reflects the impact of the cantonal tax reform, with a cut in the corporate tax rate to 7% from 8%, and stagnant tax revenues in 2022. Nontax revenues, stemming primarily from the sale of products and services at the utility entities, are expected to moderately increase from 2019-2023, while transfers are forecast to increase from 2021-2023 related to the canton's compensational payments, which are linked to the corporate tax reform. In our 2019 base-case scenario, we expect deficits after capital accounts of Swiss franc (CHF) 330 million and CHF351 million in 2019 and 2020, respectively, despite our assumption that not all capex will be realized. A major part of the capex is budgeted for industrial services (utility entities), but also for construction and refurbishment of hospitals, housing, and other buildings. In our view, pension obligations are fully funded and do not constrain Zurich-City's budgetary performance.

We expect the city will finance deficits partially with new borrowings that will stabilize its debt burden at a moderate 65%-70% of operating revenues until 2021. In recent years, Zurich-City has repaid substantial debt. Direct debt and tax-supported debt is the same for the city, because all relevant utility entities are consolidated in its balance sheet. Zurich-City is very active in the Swiss capital market and extended its maturity profile to 2046, consistent with the lifetime of some of its investment projects. The city has no major contingent liabilities due to the consolidation of its utility entities in its accounts, and those minimal ones remaining have low risk of materialization.

Deficits after capital accounts will also drain Zurich-City's liquidity and, in our base-case scenario, liquidity should drop below the average minimum of about CHF300 million. Average liquidity levels should be replenished with short-term borrowings, if levels drop below planned levels. For managing liquidity, Zurich-City has access to three committed credit lines of about CHF800 million, which support its debt service coverage ratio. Nevertheless, we view the coverage ratio as weak, with short-term and long-term annual debt repayments at just below 80% of debt service. We do not view this as a credit risk for Zurich-City, because the city's access to the deep and liquid CHF capital market is strong. Our overall assessment of Zurich-City's liquidity as strong takes into account existing cash, committed undrawn credit lines, and strong access to the Swiss capital market.

Key Statistics

Table 1

City of Zurich Selected Indicators

	--Fiscal year ended Dec. 31--					
(Mil. CHF)	**2016**	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**
Operating revenues	7,847	7,912	7,901	7,742	8,082	8,088
Operating expenditures	6,856	6,863	6,886	7,047	7,383	7,341
Operating balance	991	1,049	1,015	695	700	747
Operating balance (% of operating revenues)	12.6	13.3	12.8	9.0	8.7	9.2
Capital revenues	61	45	68	201	167	239
Capital expenditures	885	860	992	1,226	1,218	1,313
Balance after capital accounts	168	234	92	(330)	(351)	(327)
Balance after capital accounts (% of total revenues)	2.1	2.9	1.1	(4.1)	(4.3)	(3.9)
Debt repaid	1,422	943	798	825	890	850
Gross borrowings	743	709	548	848	1,200	1,250
Balance after borrowings	(684)	(34)	(196)	(353)	(62)	73
Direct debt (outstanding at year-end)	6,137	5,907	5,597	5,074	5,284	5,584
Direct debt (% of operating revenues)	78.2	74.7	70.8	65.5	65.4	69.0
Tax-supported debt (outstanding at year-end)	6,137	5,907	5,597	5,074	5,284	5,584
Tax-supported debt (% of consolidated operating revenues)	78.2	74.7	70.8	65.5	65.4	69.0
Interest (% of operating revenues)	1.9	1.7	1.6	1.4	1.6	1.5
Local GDP per capita (CHF)	169,916	168,616	166,424	168,692	171,877	173,881
National GDP per capita (CHF)	78,568	78,917	80,700	82,087	83,747	85,580

Note: 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

City of Zurich Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1
Budgetary performance	2
Liquidity	2
Debt burden	3
Stand-alone credit profile	aa+
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 10, 2019. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Default, Transition, and Recovery: 2018 Annual International Public Finance Default Study And Rating Transition Study, Aug. 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Local Government Debt 2019: Slower Debt Reduction For German States And Little Change For Swiss And Austrian LRG Debt, March 1, 2019
- Research Update: Canton of Zurich 'AAA' Ratings Affirmed; Outlook Stable, Nov. 23, 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

New Rating; Outlook Action	
Zurich (City of)	
Issuer Credit Rating	AA+/Stable/--